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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1957

No. 119

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER,

vs.

NEIL SULLIVAN AND GRACE SULLIVAN; JAMES ROSS AND ANN ROSS; SAM MESI

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR CERTIORARI FILED MAY 9, 1957

CERTIORARI GRANTED JUNE 17, 1957

SUPREME COURT OF THE UNITED STATES

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[fol. 1]

IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Docket No. 48593

JAMES ROSS AND ANN ROSS, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appendix to Petitioners' Brief (Ross Case)

APPEARANCES:

For Petitioner: E. J. Blair, Esq.
For Respondent: George T. Donaghue, Jr., Esq.

DOCKET ENTRIES. (Ross Case)

1953

May 20—Petition received and filed. Taxpayer notified. Fee paid.
May 21—Copy of petition served on General Counsel.
May 20—Notice of appearance of E. J. Blair as counsel filed.
Jul. 6—Answer filed by General Counsel.
Jul. 6—Request for hearing in Chicago, Illinois filed by General Counsel.
Jul. 13—Notice issued placing proceeding on Chicago, Illinois calendar. Service of answer and request made.

1954

Jul. 6—Hearing set October 4, 1954, Chicago, Illinois.
Sept. 3—Motion for leave to file amendment to answer, amendment to answer lodged, filed by General Counsel. 9-7-54 Granted.
Sept. 8—Copy of motion and amendment to answer served on petitioner.
[fol. 2] Sept. 10—Motion to remove proceeding from the Chicago, Illinois calendar of 10-4-54 filed by petitioner. 9-10-54 Granted. 9-13-54 Served.

1954

Oct. 18—Reply to amendment to answer filed by taxpayer. Copy served.

Dec. 7—Hearing set January 24, 1955, Chicago, Illinois.

1955

Jan. 31—Hearing had before Judge Fisher, on the merits, on respondent's oral motion for exclusion of witnesses, no objection by petitioner, and on petitioner's motion to consolidate with docket 48594 for hearing, motions granted. Stipulation of facts filed at hearing. Briefs due 5/2/55. Replies due 6/1/55.

Feb. 10—Transcript of hearing 1/31/55 filed.

Apr. 26—Motion for extension of time to 6/16/55 to file brief filed by General Counsel. 4/26/55 Granted.

Apr. 29—Brief filed by taxpayer.

Jun. 16—Brief filed by General Counsel. Served.

Jun. 17—Copy of petitioner's brief served on General Counsel.

Jul. 12—Motion for extension to August 31, 1955, to file reply brief filed by taxpayer. 7/13/55 Granted. 7/14/55 Copy served.

Aug. 22—Reply brief filed by taxpayer. Copy served.

1956

Jan. 13—Memorandum findings of fact and opinion filed. Fisher, Judge. Decision will be entered under Rule 50. Copy served 1/13/56.

Mar. 13—Agreed computation for entry of decision filed.

Mar. 19—Decision entered, Judge Fisher, Div. 15.

Jun. 5—Petition for review by United States Court of Appeals, Seventh Circuit, filed by petitioner.

Jun. 5—Proof of service filed.

[fol. 3] Jun. 8—Statement of points with statement of service by mail thereon filed.

Jun. 8—Designation of record on review with statement of service by mail thereon filed.

Jul. 2—Order extending time for filing the record on review and docketing the petition for review to September 3, 1956, entered. Served 7/3/56.

Docket No. 48594.

NEIL SULLIVAN and GRACE SULLIVAN, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

APPEARANCES:

For Petitioner: E. J. Blair, Esq.
For Respondent: George T. Donaghue, Jr., Esq.

DOCKET ENTRIES. (SULLIVAN CASE)

1953

May 20—Petition received and filed. Taxpayer notified. Fee paid.

May 21—Copy of petition served on General Counsel.

May 20—Notice of appearance of E. J. Blair as counsel filed.

Jul. 6—Answer filed by General Counsel.

Jul. 6—Request for hearing in Chicago, Illinois filed by General Counsel.

Jul. 9—Notice issued placing proceeding on Chicago, Illinois calendar. Service of answer and request made.

1954

Jul. 6—Hearing set October 4, 1954, Chicago, Illinois.

Sept. 3—Motion for leave to file amendment to answer, amendment to answer lodged, filed by General Counsel. 9 7 54 Granted.

[fol. 4] Sept. 8—Copy of motion and amendment to answer served on petitioner.

Sept. 10—Motion to remove proceeding from the Chicago, Illinois calendar of 10 4 54 filed by petitioner. 9 10 54 Granted. 9 13 54 Served.

Oct. 18—Reply to amendment to answer filed by Neil Sullivan, with death certificate of Grace Sullivan attached. Copy served.

Dec. 7—Hearing set January 24, 1955, Chicago, Illinois.

1955

Jan. 31—Hearing had before Judge Fisher, on the merits, on respondent's oral motion for exclusion of witnesses, no objection by petitioner, and on petitioner's motion to consolidate with docket 48593 for hearing, motions granted. Stipulation of facts filed at hearing. Briefs due 5 2 55. Replies due 6 1 55.

Feb. 10—Trafiscript of hearing 1 31 55 filed.

Apr. 26—Motion for extension of time to 6 16 55 to file brief filed by General Counsel. 4 26 55 Granted.

Apr. 29—Brief filed by taxpayer.

Jun. 16—Brief filed by General Counsel. Served.

Jun. 17—Copy of petitioner's brief served on General Counsel.

Jul. 12—Motion for extension to August 31, 1955, to file reply brief filed by taxpayer. 7 13 55 Granted. 7 14 55 Copy served.

Aug. 22—Reply brief filed by taxpayer. Copy served.

1956

Jan. 13—Memorandum findings of fact and opinion, filed. Fisher, Judge. Decision will be entered under Rule 50. Copy served 1 13 56.

Mar. 13—Agreed computation for entry of decision filed.

Mar. 19—Decision entered, Judge Fisher, Div. 15.

Jun. 5—Petition for review by United States Court of Appeals, Seventh Circuit, filed by petitioner.

[fol. 5] Jun. 5—Proof of service filed.

Jun. 8—Statement of points with statement of service by mail thereon filed.

Jun. 8—Designation of record on review with statement of service by mail thereon filed.

Jul. 2—Order extending time for filing the record on review and docketing the petition for review to September 3, 1956, entered. Served 7 3 56.

THE TAX COURT OF THE UNITED STATES

JAMES ROSS and ANN ROSS, Petitioners

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

NEIL SULLIVAN and GRACE SULLIVAN, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket Nos. 48593, 48594

Findings of Fact and Opinion—January 13, 1956

During the taxable years 1948, 1949 and 1950, James Ross and Neil Sullivan were equal partners operating an illegal bookmaking business in Chicago, Illinois. In those years, the partnership return disclosed, respectively, gross profits of 6.86 per cent, 6.46 per cent and 5.56 per cent of total bets received. In his statutory notice of deficiency, respondent accepted the accuracy of the reported gross receipts and operating expenses, but disallowed the deduction of "pay outs" in excess of 86 per cent of amounts wagered. Respondent thereafter, in his amended answer, asserted additional deficiencies based upon the claim of illegality of payments for wages and rent in the conduct of a bookmaking business in the State of Illinois. Fraud was not alleged, and there was no evidence of fraud in the record. There was, however, no practical way for respondent to verify the correctness of petitioner's books and records by independent check, especially as to "pay outs" to winning bettors. *Held*.

[fol. 6] (a) Respondent's disallowance of a portion of claimed "pay outs" disapproved where calculated upon a ratio determined on the basis of data unrelated to petitioners' business or similar businesses.

(a) Respondent sustained in disallowing deductions for wages and rent paid in violation of Illinois law in the conduct of a bookmaking business.

(c) Penalties are allowed under sections 294(d)(1)(A) and 294 (d) (2) of the Internal Revenue Code of 1939. Penalties under 293(a) are disallowed.

E. J. Blair, Esq., for the petitioners.
George T. Donahue, Jr., Esq., for the respondent.

Memorandum Findings of Fact and Opinion

These are consolidated proceedings in which the respondent determined deficiencies in income taxes and penalties as follows:

Petitioners	Year	Tax	Deficiency	Sec. 293 (a) Penalty	Sec. 294 (d) (1) (A) Penalty	Sec. 294 (d) (2) Penalty
James Ross & Ann Ross	1948	Income	$13,407.14	$ 670.36	$1,593.28	$ 955.97
" "	1949	"	15,429.66	771.48	1,741.16	1,044.69
" "	1950	"	22,383.98	1,119.20	2,437.42	1,462.45
Neil Sullivan & Grace Sullivan	1948	Income	$13,254.02	$ 662.70	$1,562.13	$ 937.28
"	1949	"	15,255.36	762.77	1,709.99	1,025.99
"	1950	"	21,990.86	1,099.54	2,369.71	1,421.82

Respondent claimed increased deficiencies in the amendments to his answers as follows:

Petitioners	Year	Tax	Deficiency	Sec. 293 (a) Penalty	Sec. 294 (d) (1) (A)[1] Penalty	Sec. 294 (d) (2) Penalty
James Ross & Ann Ross	1948	Income	$ 7,403.52	$ 370.17	$ 740.36	$ 444.21
"	1949	"	8,726.25	436.32	872.60	523.57
"	1950	"	9,583.78	479.19	575.03	958.38
Neil Sullivan & Grace Sullivan	1948	Income	$ 7,387.68	$ 369.39	$ 738.77	$ 443.26
"	1949	"	8,694.64	434.73	869.45	521.68
"	1950	"	9,517.70	475.89	951.77	571.06

[1] These sections and the same sections on the previous page refer to the Internal Revenue Code of 1939.

[fol. 7] The issues presented involve:

(a) Disallowance by formula of a percentage of "pay outs" to winning bettors claimed to have been made by a partnership of bookmakers;

(b) Disallowance of deductions for wages and rent paid by bookmakers in violation of Illinois law;

(c) Application of penalties under sections 293(a); 294(d)(1)(A); and 294(d)(2) of the Internal Revenue Code of 1939.

Findings of Fact

The petitioners James Ross and Ann Ross are individuals with residence at 3520 Lake Shore Drive, Chicago, Illinois. Their joint Federal income tax returns for the calendar years 1948, 1949 and 1950 were timely filed with

the then collector of internal revenue for the first district of Illinois.

The petitioners Neil Sullivan and Grace Sullivan are individuals with residences at 5151 Kenmore Avenue, Chicago, Illinois. Their joint Federal income tax returns for the calendar years 1948, 1948 and 1950 were timely filed with the then collector of internal revenue for the first district of Illinois.

During the taxable years in question, petitioners Jimmy Ross and Neil Sullivan were equal partners engaged in the bookmaking business in Chicago, Illinois. Each of them invested a few hundred dollars as the original capital of the partnership. During the taxable years, the business of the partnership was conducted in various leased rooms on the upper floors of an hotel located at 411 South Wabash Avenue, in the central business district of Chicago. Customers of the partnership were usually directed to its place of business in the hotel by one of its employees or by other customers.

The partnership accepted bets from various individuals [fol. 8] and agreed to pay the bettor if he won his bet, such odds as were shown by the pari-mutuel machines of the various race tracks located in different parts of the country, with the limitation that in no event would it pay more than $30 for $1.00, in respect of "win"; $12 for $1.00 in respect of "place", and $6.00 for $1.00 in respect of "show". To win a "win" bet the horse wagered on must come in first; to win a "place" bet the horse wagered on must come in first or second; and to win a "show" bet the horse wagered on must come in first, second or third. To win a daily double bet, the bettor must select in advance the winning horses in two races at a particular track, usually the first and second races. Parlay bets are similar to daily double wagers, except they may be made to win, place or show and may be made on two or more horses at the same or different tracks. Like daily double bets, the horses must be selected in advance, and all must win, place or show, depending on how they were bet to finish.

A "scratch" occurs when a horse entered in a race is withdrawn shortly before the running of the race. "Scratches" on which the partnership had accepted wagers did not occur in substantial number during the [illegible]

a year. In the case of a "scratch", the wager was returned to the bettor, and the repayment was recorded on the partnership records as an "out" in the same amount as the wager.

The bets placed by patrons of the partnership were recorded on printed forms known as safety tickets, the originals of which were given to the patrons, and the carbon copies of which were retained by the partnership. These safety tickets were printed in duplicate in books of ten pages with twenty tickets to a page, each ticket bearing a printed number. On these safety tickets in the spaces provided for the purpose, was written the information containing the number of the horse, the kind of the bet, such as at [fol. 9] "win," "place" or "show," et cetera, and the amount of the bet.

A large cardboard sheet, commonly called a hard card, for each track was hung on the wall in the partnership's place of business each day. The hard card showed the entries for the day, the jockeys and probable odds. Each horse was shown by name and number and the number corresponded to the number written in on the safety ticket when a bet was made on the horse.

The partnership subscribed to a wire service which gave information over a loud speaker such as the time when the race commenced, the progress of the race until it ended, the result, and then the odds payable at the track to the winners of win, place and show bets on the basis of $2.00 bets. A winner was required to present the original ticket to collect his wager. When a winner presented the original, it was checked against the carbon copy of the partnership, and if the carbon copy showed it to be a winning ticket the notation of the amount payable was entered thereon and the bettor was paid according to the amount of the wager and the odds at the track at which the horse ran, subject to the limitations in amount set forth above.

At the close of each day the partnership totaled the sums shown as wagered, i. e., "ins," and the sums shown as payable to winning wagerers, i. e., "outs," as they appeared on its records. These totals, together with its various expenses, were entered on a daily summary sheet. This daily summary sheet was sent to the accountant employed by the partnership.

The partnership did not preserve the original safety tickets presented by winning patrons for the years in question. It did preserve the carbon copies of the safety tickets for each day of operation and the daily summary sheets which were made from these carbon copies. Each day the partnership placed within the folded hard cards the carbon [fol. 10] copies of the safety tickets, together with adding machine tapes showing the total "ins" and the "outs." The records thus prepared and preserved were given to the accountant for the partnership, and from these he prepared monthly summary sheets. The monthly summary sheets were recapitulated and served as the basis for the preparation of the partnership's income tax returns for the years involved herein. The returns were prepared on the cash receipts and disbursements basis.

During the taxable years, equal cash withdrawals were made by petitioners from the partnership sometimes as often as twice a week but not less than once a month. These cash withdrawals were not recorded on the books and the records of the partnership.

The partnership books and records included a cash account, and capital accounts for the partners. No bookkeeping record was made of cash withdrawals by the partners. As a result, neither the cash account nor the capital accounts were accurate during the years in question, since they were not reduced by such withdrawals. The accountant merely used them on his own initiative as in the nature of closing accounts to keep the double entry books in balance. While the accounting procedures so used were not correct or proper, they did not have the effect of distorting income. The only practical effect was to show a continuing accumulation of cash and capital which did not in fact exist. The accountant did not know the amount of cash withdrawals made by petitioners, or the actual amount of cash in the partnership at any particular time.

The accountant did not make any test to ascertain whether any of the "outs" shown on the partnership's records for the years involved were, in fact, amounts paid to winning bettors. He occasionally verified the arithmetical accuracy of the daily summary sheets. He was not shown the daily cash reconciliations.

[fol. 11] On frequent occasions during the taxable years, the place of business of the partnership was raided by the

police. With the exception of Sundays and holidays, the partnership conducted its operations on all days during the taxable years although it stopped business before its regular closing hour on those days on which its place of business was raided by the police. It changed its rooms in the hotel from time to time because of such raids. A number of petitioners' employees were arrested as a result of said raids, but neither of the partners was ever arrested.

At the time of examination, the revenue agent found that some of the pads of safety tickets were missing, and that the consecutive order of pads was not complete. He did not make any effort to ascertain how many more there might have been. He did verify, however, that the income on the partnership returns checked with the records furnished him. The pads were not necessarily used in alphabetical or numerical sequences.

Petitioners did not identify any of the individuals to whom the partnership paid winning bets during the taxable years, although they were questioned in this regard during the revenue agent's examination and at the hearing.

In its returns, the partnership reported total "ins" and "outs," losses from "hedging" and gross profit for the years 1948, 1949 and 1950, as follows:

Year	Total "Ins"	Total "Outs" and and Losses from "Hedging"	Gross Profit	Percentage
1948	$ 944,295.55	$ 879,505.60	$64,789.95	6.86
1949	1,030,671.00	964,098.00	66,573.00	6.46
1950	1,197,365.10	1,130,789.00	66,576.10	5.56

Of the amount claimed in the partnership returns as paid out on winning wagers, the respondent disallowed the following:

Year	Disallowed
1948	$ 67,411.42
1949	77,660.94
1950	101,055.01

[Fol. 12] The disallowance was based upon the assumption that the "outs" approximated 86 per cent of the amounts bet, and the "outs" claimed on the partnership returns for the years in question in excess of such percentage were disallowed on this theory.

At pari-mutuel racing tracks throughout the United States 10 per cent to 17 per cent of all bets placed is deducted for the racing association and the taxing authorities, and the remaining 90 per cent to 83 per cent is distributed to winning bettors. Under the laws of Illinois for the years 1948, 1949 and 1950, approximately 13 per cent of every dollar bet at the tracks was deducted from the mutuel pool, part of which was retained by the racing association and part of which was paid to the State. In addition to the part retained by the racing association, it also received and retained breakage to the dime, which amounts to approximately 1½ per cent of the totals wagered. The remaining 85½ per cent was distributed to the winning bettors.

The partnership in the conduct of its business of bookmaking paid total wages to its six or seven employees and deducted them in its returns for the taxable years as follows:

Year	Wages
1948	$18,950.00
1949	22,935.00
1950	23,390.00

The services of the employees for these wages were performed in the operation of the bookmaking business of the partnership, including the recording of bets.

The partnership paid total rent to the lessor of the various hotel rooms in which it conducted its business of bookmaking and deducted the rent in its returns for the taxable years as follows:

Year	Rent
1948	$8,735.00
1949	3,200.00
1950	9,215.00

[fol. 134] The lessor knowingly permitted these rooms to be used for the purposes of bookmaking.

The acts performed by the employees of the partnership and the lessor in return for the wages received by the former, and the rent received by the latter, constituted violations of section 336 of the Criminal Code of the State of Illinois. The payment of said wages and rent constituted a violation of section 582 of said Code.

Respondent determined penalties against petitioners for each of the years in question for failure to file declarations of estimated tax. The amounts of gross income disclosed on the returns filed by petitioners for said years were sufficient in themselves to have required petitioners to file declarations of estimated tax under the provisions of section 58 of the Internal Revenue Code of 1939. Petitioners do not deny that they failed to file such declarations of estimated tax and have presented no evidence to show that such failure was due to reasonable cause and not to wilful neglect.

Eighty per centum of the taxes of petitioners for each of the years in question was in excess of the estimated tax (which was zero) for each of said years.

No part of the deficiency in any of the years here in question was due to negligence or intentional disregard of rules and regulations on the part of petitioners, or any of them.

Opinion

Fisher, *Judge:* This is another bookmaker case, quite similar, in many respects, to *Sam Mesi*, 25 T.C. (filed December 16, 1955).

The first issue involves the disallowance by respondent of all "outs" in excess of 86 per cent of the amounts bet. The statutory notice of deficiency does not contest the accuracy of the gross receipts or the operating expenses, and does not purport to disallow any particular "outs." The [fol. 14] disallowance of "outs" in excess of the percentage above referred to was based on a formula applied because, as the investigation agent testified, in rather vague language, "the industry generally should figure on paying out about 86 per cent—$86 for every hundred dollars bet * * *." It is evident that this figure was based substantially upon the fact that lawful pari-mutuel tracks in Illinois in 1948, 1949 and 1950 distributed to winning bettors 85½ per cent of amounts bet. (In the United States generally, pari-mutuel race tracks distributed from 83 per cent to 90 per cent to winning bettors.) As we recognized in *Sam Mesi*, *supra*, and have held in numerous other cases, there is no relation between the amounts distributed to winners by mutuel tracks (where the track, for practical purposes, is only a stakeholder) and the gross profits of a bookmaker

who bets against the customer. It is apparent, therefore, that the formula on which respondent relies is here inapplicable.

Respondent's statutory notice determines no fraud, mathematical inaccuracy, or specific discrepancy with respect to the "outs." This position is, in substance, that there is no practical way in which he can verify by audit the amount of the "outs," because petitioners did not require receipts for "outs" or obtain the names and addresses of winning bettors. We doubt whether such data would have been of material assistance in an audit because it is unlikely that true names and addresses would have been furnished to bookmakers. We recognize the difficulty of an effective audit, however, but we do not think the solution lies in the effort to apply an unrealistic formula. Other techniques, such as the determination of income by the net worth increase method, have been developed which have been quite effective in ferreting out unreported income where the usual auditing methods are inadequate. No such method has been availed of in the instant case.

[fol. 15] The investigating agent had access to the "hard cards" and carbons of "safety tickets." It is true that he testified that some pads of "safety tickets" were missing, and some not in consecutive order but he made no effort to find out if they were in any other place, and did not indicate the extent to which they were missing or misplaced. He did not suggest that there was any indication that any of them had been destroyed. Moreover, the ledger sheets showing the posting of monthly totals were furnished to him. He testified that he verified that "the partnership returns jibed directly with the records furnished me."

It is clear from the record that, assuming that the entries were honestly made, the books and records were adequate to reflect income for income tax purposes. It is true that there was no practical way to verify specific "outs." Moreover, we naturally approach with suspicion any issue involving the conduct of an illegal business. Nevertheless, no fraud was alleged. The test of net worth increase was not used. Falsification of the books and records would have required collusion on the part of employees as well as the partners. No specific inaccuracies or falsifications were discovered with respect to such "outs" and no specific "outs" were disallowed.

Under the circumstances, we cannot arbitrarily apply an inapplicable formula. Respondent has made no determination disallowing specific "outs" and we find no basis for determining or measuring a deficiency by disallowing a portion thereof. By the same token, we find no support in the record for application of the rule of *Cohan* v. *Commissioner*, 39 F. 2d 540 (C. A. 2, 1930) to this issue, as urged by respondent. In fine, there is nothing in the case which warrants us in disregarding the "outs" as established by petitioners' books and records.

The next issue concerns additional deficiencies proposed [fol. 16] by respondent in his amended answers attributable to disallowance of wages and rent paid by the partnership. Respondent's contention is that such payments violated Illinois law, and are not allowable because contrary to public policy.

Section 336 of the Criminal Code of the State of Illinois provides as follows:

Illinois Revised Statutes 1945 (Burdette Smith).

> 336. * * * That any person who keeps any room, shed, tenement, tent, booth or building, or any part thereof, or who occupies any place upon any public or private grounds within this State with any book, instrument or device for the purpose of recording or registering bets or wagers, or of selling pools, or any person who records or registers bets or wagers, or sells pools upon the result of any trial or contest of skill, speed or power of endurance of man or beast, or upon the result of any political nomination, appointment or election, or being the owner, lessee or occupant of any room, shed, tenement, tent, booth or building, or part thereof, knowingly permits the same to be used or occupied for any of these purposes, or therein keeps, exhibits or employs any device or apparatus for the purpose of recording or registering such bets or wagers, or selling of such pools, or becomes the custodian or depository for hire or privilege, of any money, property, or thing of value staked, wagered or pledged upon any such result, shall be punishable by imprisonment in the county jail for a period not longer than one year, or by fine not exceeding $2,000 or both.

> Provided, however, that the provisions of this act shall not apply to the actual enclosure of fair or race track associations that are incorporated under the laws of this state, during the actual time of the meetings of said associations, or within twenty-four hours before any such meetings.

[fol. 17] In addition, section 582 of the Criminal Code of the State of Illinois provides:

> Illinois Revised Statutes 1945 (Burdette Smith).
>
> 582. * * * § 2. An accessory is he who stands by, and aids, abets or assists, or who not being present, aiding, abetting or assisting, hath advised, encouraged, aided, or abetted the perpetration of the crime. He who thus aids, abets, assists, advises or encourages, shall be considered as principal, and punished accordingly.

With respect to wages, the specific issue was before us in *Sam Mesi*, *supra*, which is here controlling. After a full discussion of the applicable principles and decisions relating to the disallowance of illegal expenses, we said, in part:

> Pursuant to these sections of the Criminal Code of the State of Illinois, the payment of the wages in question in and of itself constituted an illegal act. The wages paid by petitioner were paid to procure the direct aid of others in the perpetration of an illegal act, namely, the operation of a bookmaking establishment. Certainly, it would be a clear violation of public policy to permit the deduction of an expenditure, the making of which constitutes an illegal act.

While we had no occasion to consider the question of rents in the *Mesi* case, we think that the principles there announced are equally applicable to rental payments on the facts presented in the instant case. It is clear that the lessor as well as the lessees were fully aware that an illegal bookmaking enterprise was being carried on upon the premises, and that both the payment and receipt of rentals were in violation of sections 326 and 582 of the Illinois Revised Statutes cited above.

We hold, therefore, that the deduction of wages and rents must be disallowed.

[fol. 18] Respondent determined penalties for each of the years involved under section 294(d)(1)(A) for failure to make and file a declaration of estimated tax. The gross income reported on the returns filed by petitioners for each of the years in question was alone clearly sufficient to require the filing of such declarations under the provisions of section 58. Since petitioners do not deny that they failed to file such declarations, and since they offer no evidence to show that such failure was due to reasonable cause and not to wilful neglect, it is clear that such penalties will apply, the amount to be determined in a computation under Rule 50.

A penalty for each year was likewise determined under section 294(d)(2) for substantial understatement of estimated tax. Since we have found as a fact that 80 per centum of the taxes of petitioners for each of the years in question was in excess of the estimated tax (which latter was zero, since no estimate was filed) it is again apparent that such penalties will apply. *G. E. Fuller* (1953) 20 T. C. 308, 316, affd. (C. A. 10) 213 F. 2d 102. The amount thereof will likewise be determined under Rule 50.

We take a different view, however, with respect to penalties under section 293(a). Here, penalties may be applied only if there is a deficiency, and if any part of such deficiency is due to negligence or intentional disregard of rules and regulations. Since we have held that the respondent erred in disallowing any part of the "rents" deducted by petitioners, no part of any deficiencies are attributable thereto. While we have sustained respondent in the disallowance of deductions for wages and rent, we think that the state of the law on these issues was unsettled prior to our Opinion in *Sam Mesi, supra*, which was not published until December 16, 1955, long after the returns in issue were filed and the deductions taken. We think it is [fol. 19] clear, therefore, that the resultant deficiencies are not to be regarded as due to any negligence or intentional disregard of rules and regulations by petitioners. We hold, therefore, that penalties under section 293(a) do not here apply.

Decisions will be entered under Rule 50.

THE TAX COURT OF THE UNITED STATES

Washington.

Docket No. 48593.

JAMES ROSS AND ANN ROSS, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DECISION (ROSS CASE)—Entered March 19, 1956

Pursuant to the Memorandum Findings of Fact and Opinion filed January 13, 1956, the parties on March 13, 1956, having filed an agreed computation of the tax, it is

Ordered and Decided: There are deficiencies in income tax and penalties as follows:

Year	Deficiency	Sec. 293 (a) Penalty	Sec. 294 (d) (1) (A) Penalty	Sec. 294 (d) (2) Penalty
1948	$4,362.18	None	$676.92	$413.27
1949	4,886.44	None	618.15	412.09
1950	5,100.10	None	638.14	425.42

Entered Mar. 19, 1956.

(Seal) Morton P. Fisher, Judge.

[fol. 20] THE TAX COURT OF THE UNITED STATES

Washington.

Docket No. 48594.

NEIL SULLIVAN AND GRACE SULLIVAN, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DECISION (SULLIVAN CASE)—Entered March 19, 1956

Pursuant to the Memorandum Findings of Fact and Opinion filed January 13, 1956, the parties on March 13, 1956, having filed an agreed computation of the tax, it is

Ordered and Decided: There are deficiencies in income tax and penalties as follows:

Year	Deficiency	Sec. 293 (a) Penalty	Sec. 294 (d) (1) (A) Penalty	Sec. 294 (d) (2) Penalty
1948	$4,293.54	None	$[illegible]	$899.65
1949	4,796.68	None	597.71	398.47
1950	4,914.52	None	595.87	397.25

Entered Mar. 19, 1956.

(Seal) Morton P. Fisher, Judge.

[fol. 21] United States Court of Appeals for the Seventh Circuit

T. C. Docket No. 48593

James Ross and Ann Ross, Petitioners on Review,

vs.

Commissioner of Internal Revenue, Respondent on Review

Petition of Review (Ross Case)—Filed June 5, 1956

The petitioners, James Ross and Ann Ross, hereby petition for a review by the United States Court of Appeals for the Seventh Circuit of that part of the decision entered by The Tax Court of the United States on March 19, 1956, in T. C. Docket No. 48593, ordering and deciding that there are deficiencies in income tax and penalties under the provisions of the Internal Revenue Code of 1939 for the taxable years 1948, 1949 and 1950, as follows:

Year	Deficiency	Sec. 294 (d) (1) (A) Penalty	Sec. 294 (d) (2) Penalty
1948	$4,362.18	$619.92	$413.27
1949	4,886.44	618.15	412.09
1950	5,100.10	638.13	425.42

Petitioners, James Ross and Ann Ross, were husband and wife during the years involved in this proceeding and filed their joint income tax returns with the Collector of Internal Revenue for the First District of Illinois, whose office is located within the jurisdiction of the United States Court of Appeals for the Seventh Circuit.

The above named petitioners filed this petition pursuant to the provisions of Sections 7482 and 7483 of the Internal [fol. 22] Revenue Code of 1954. This controversy involves Federal income taxes for the years 1948, 1949 and 1950.

E. J. Blair, 77 W. Washington Street, Chicago 2, Illinois, Counsel for Petitioners.

United States Court of Appeals for the Seventh Circuit

T. C. Docket No. 48594

Neil Sullivan and Grace Sullivan, Petitioners on Review,

vs.

Commissioner of Internal Revenue, Respondent on Review

Petition of Review (Sullivan Case)—Filed June 5, 1956

The petitioners, Neil Sullivan and Grace Sullivan hereby petition for a review by the United States Court of Appeals for the Seventh Circuit of that part of the decision entered by The Tax Court of the United States on March 19, 1956, in T. C. Docket No. 48594, ordering and deciding that there are deficiencies in income tax and penalties under the provisions of the Internal Revenue Code of 1939 for the taxable years 1948, 1949 and 1950, as follows:

Year	Deficiency	Sec. 294 (d) (1) (A) Penalty	Sec. 294 (d)-(2) Penalty
1948	$4,293.54	$599.47	$399.65
1949	4,796.68	597.71	398.47
1950	4,914.52	595.87	397.25

Petitioners, Neil Sullivan and Grace Sullivan, were husband and wife during the years involved in this proceeding [fol. 23] and filed their joint income tax returns with the Collector of Internal Revenue for the First District of Illinois, whose office is located within the jurisdiction of the United States Court of Appeals for the Seventh Circuit.

The above named petitioners file this petition pursuant to the provisions of Sections 7482 and 7483 of the Internal

Revenue Code of 1954. This controversy involves Federal income taxes for the years 1948, 1949 and 1950.

E. J. Blair, 77 W. Washington Street, Chicago 2, Illinois, Counsel for Petitioners.

[fol. 24] In the United States Court of Appeals for the Seventh Circuit, September Term, 1956, January Session, 1957

No. 11841

Neil Sullivan and Grace Sullivan, Petitioners,

vs.

Commissioner of Internal Revenue, Respondent

No. 11842

James Ross and Ann Ross, Petitioners,

vs.

Commissioner of Internal Revenue, Respondent

Petitions for Review of Decisions of the Tax Court of the United States

Decision—February 13, 1957

Before Lindley, Swaim and Schnackenberg, Circuit Judges

Schnackenberg, *Circuit Judge*. Petitioners seek a review[1] of that part of decisions entered by the Tax Court of the United States which determined deficiencies in their income taxes for the years 1948, 1949, and 1950, and imposed penalties therefor. The only contested issue in the cases is whether or not petitioners may deduct for income

[1] These cases came from the Tax Court on a consolidated record.

tax purposes unlawful payments of wages and rent in connection with the unlawful operation in Illinois of a bookmaking establishment by petitioners Neil Sullivan and James Ross.

This legal issue was presented, argued and decided by this court in *Commissioner of Internal Revenue v. Doyle*, 231 F.2d 635, where the Commissioner himself stated the question there presented to us for decision, in this language: Whether expenses for rent and wages incurred in the operation of an illegal gambling business are themselves contrary to a sharply defined and declared public policy of the state of Illinois and hence are not deductible for income tax purposes, within the meaning of sec. 23(a), Internal Revenue Code of 1939. In our opinion, we accepted and decided the question as thus stated. In this case, the Commissioner states the contested issue thus: Whether a taxpayer may deduct for income tax purposes payments of rent and wages which were made in violation of criminal statutes of the state of Illinois.[2] It does not appear that the Commissioner applied to the United States Supreme Court for *certiorari* to review our decision in the *Doyle* case. It does appear that, before a single judge of the Tax Court who tried the case at bar the Commissioner contended and now contends that the holding of this court in the *Doyle* case should not be followed. If the Commissioner feels that the decision in the *Doyle* case was wrong he should have, by application for *certiorari*, afforded the Supreme Court an opportunity to pass upon his contentions. Lacking such a decision by the highest court, a decision by one judge of the Tax Court, which, in effect, overrules a decision of the court of appeals in the circuit in which both cases arose, is not consonant with the responsibilities of the respective tribunals involved. To the same effect is *Stacey Mfg. Co. v. Commissioner of Internal Revenue*, 237 F.2d 665.

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[2] In the *Doyle* case, the Commissioner relied on only the following statutes of the state of Illinois: ¶¶ 139, 140, 336 and 582, chapter 38 (Criminal Code) Illinois Revised Statutes, 1945. He relies upon the same statutes in the case at bar.

Our opinion in the *Doyle* case neither expressly treated, nor by any possible inference can be construed as treating, the wages and rent paid by the taxpayer as "legitimate" expenses. The word "legitimate", upon which the Commissioner now relies in an attempt to distinguish the *Doyle* case, was used by the Tax Court in its decision in the *Doyle* case, but not by us. We made it clear, at 636, that sec. 23(a),[3] in setting forth what trade or business expenses are to be deducted from gross income in computing net income, makes no distinction between *lawful* and *unlawful* disbursements.

On the authority of the *Doyle* holding, to which we adhere, the decision of the Tax Court is reversed and the cause is remanded[4] for the sole purpose of a redetermination of the penalties, if any, assessable solely on the basis of income reported by petitioners in their returns.

Reversed and Remanded.

[fol. 25] UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 11842

JAMES ROSS and ANN ROSS, Petitioners,

vs.

COMMISSIONERS OF INTERNAL REVENUE, Respondent

Petition for Review of a Decision of the Tax Court of the United States

JUDGMENT (Ross Case)—February 13, 1957

This cause came on to be heard on the transcript of the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by

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[3] 26 U.S.C.A. § 23(a).

[4] 26 U.S.C.A. § 7482.

this Court that the decision of the Tax Court of the United States entered in this cause on March 19, 1956 be, and the same is hereby, REVERSED, and that this cause be, and the same is hereby REMANDED to the said Tax Court of the United States for the sole purpose of a redetermination of the penalties, if any, assessable solely on the basis of income reported by petitioners in their returns, in accordance with the opinion of this Court filed this day.

[fol. 26] UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 11841

NEIL SULLIVAN and GRACE SULLIVAN, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Petition for Review of a Decision of the Tax Court of the United States

JUDGMENT (SULLIVAN CASE)—February 13, 1957

This cause came on to be heard on the transcript of the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the decision of the Tax Court of the United States entered in this cause on March 19, 1956 be, and the same is hereby, REVERSED, and that this cause be, and the same is hereby, REMANDED to the said Tax Court of the United States for the sole purpose of a redetermination of the penalties, if any, assessable solely on the basis of income reported by petitioners in their returns, in accordance with the opinion of this Court filed this day.

[fol. 27] Clerk's Certificate to foregoing Transcript (omitted in printing).

[fol. 1] The Tax Court of the United States

Docket No. 50868

Sam Mesi, Petitioner,

vs.

Commissioner of Internal Revenue, Respondent

Amended Petition (Mesi Case)—Filed January 4, 1954

The above-named Petitioner, in conformity with the notice of hearing on motion to dismiss, dated December 14, 1953, hereby amends the petition heretofore filed by him, and asks that this amended petition stand in the place and stead of the original petition. The Petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols ADC-Ap:CHI Chi:JGA), dated June 29, 1953, and as a basis of this proceeding alleges as follows:

1. The Petitioner is an individual residing at 1163 West Grand Avenue, in Chicago, Illinois. The return for the period here involved was filed with the Collector for the First District of Illinois.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A"), was mailed to the Petitioner on June 29, 1953.

3. The tax in controversy is income tax for the calendar year 1946, and the deficiency asserted amounts to $41,555.81.

4. The determination of tax set forth in the said notice of deficiency is based on the following errors:

(A) Increase in gross receipts (gross profit) from taxpayer's business in the amount of $48,010.41 for the year 1946.

(B) Disallowance of wages and compensation paid to taxpayer's employees representing ordinary and necessary expense in the conduct of his business in the amount of $14,563.84 for the year 1946.

The facts upon which the Petitioner relies as the basis of this proceeding are as follows:

[fol. 2]

A

1. During the year 1946 Petitioner was engaged in the business of operating a handbook and derived earnings from the placing of wagers with him in the city of Chicago, State of Illinois.

2. The total gross receipts derived by taxpayer from the operations of his gaming establishments were as follows:

Gaming receipts	$793,287.50
Gaming disbursements	750,069.85
Gross Receipts (or Gross Profit)	$ 43,217.65

3. The gross receipts and gross profit from taxpayer's gaming business as stated above were included by Petitioner in his income tax return for the year 1944.

4. Respondent increased Petitioner's gross receipts (actually gross profit) from said gaming business in the amount of $48,010.41, and alleged in his notice of deficiency that the method used in determining that taxpayer had derived additional gross receipts was "on the basis of information on file in the Bureau".

5. The Respondent failed to indicate any recognized accounting method that was employed in determining the alleged increase in gross receipts as asserted in his notice of deficiency. It is herewith alleged that the same is arbitrary and capricious, and that failing to show that the same was arrived at by some recognized and approved accounting method of determining said increase in Petitioner's income, the same should be stricken from the Commissioner's notice of deficiency.

6. In the alternative, it is herewith asserted that taxpayer's return as filed fully accounted for all gross receipts and gross profit from his gaming business, and that the Respondent erred in arbitrarily increasing taxpayer's gross receipts (gross profit) from his business.

B

1. During the year 1946, in connection with the operations of the said gaming business, Petitioner incurred and paid wages, to employees who aided him directly in the handling of gaming wagers, in the sum of $14,563.84.

[fol. 3] 2. The expenses incurred were ordinary and necessary and incurred directly in connection with the operations of Petitioner's gaming business.

3. Petitioner deducted the amount shown above as wages from his income tax return for the year, 1946.

4. Respondent disallowed the said amount deducted as "wages" as contrary to public policy.

5. Within the meaning and intent of Sec. 23(a) of the Internal Revenue Code and the applicable decisions of this Court and the United States Supreme Court, amounts paid directly to employees who performed direct services, even in the operations of an illegal undertaking, are nevertheless ordinary and necessary deductions, and are not contrary to public policy. The Respondent erred in disallowing the said deduction.

Wherefore, Petitioner prays that this Court may hear the proceeding and correct the assigned errors.

(S.) Howard R. Slater, Attorney for Petitioner, 77 West Washington Street, Chicago 2, Illinois, FRanklin 2-6365.

Duly sworn to by Sam Mosi (Jurat omitted in printing).

[fol. 4] Exhibit A to Amended Petition

U. S. Treasury Department

Office of the District Commissioner, Internal Revenue Service

June 29, 1953

In Replying Refer To:
Assistant District Commissioner, Appellate
Chicago District
Post Office Box FF
Chicago 90, Illinois
ADC:App:CHI
Chi:JGA
Mr. Sam Mosi
1163 West Grand Avenue
Chicago 22, Illinois

Sir:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1946

discloses a deficiency of $41,555.81 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws notice is hereby given of the deficiency mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to: Assistant District Commissioner, Appellate Division, Chicago District, Post Office Box FF, Chicago 90, Illinois. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency [fol. 5] and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Very truly yours, T. Coleman Andrews, Commissioner of Internal Revenue, by Clarence W. Sebring, Assistant District Commissioner, Appellate.

Enclosures:

Statement
Form 1276
Agreement Form 870.

Statement

Sam Mesi
1163 West Grand Avenue
Chicago 22, Illinois

Tax Liability for the Taxable Year Ended December 31, 1946.

	Deficiency
Income Tax	$41,555.81

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated June 23, 1950; to your protest dated October 26, 1950 and to the statements made at the conferences held on November 30, 1950 and April 3, 1952.

A copy of this letter and statement have been mailed to your representative, Mr. Philip C. Corrado, 77 W. Washington Street, Chicago 2, Illinois, in accordance with the power of attorney executed by you.

Adjustments to Net Income

Net income as disclosed by original return	$16,898.50
Additional income and unallowable deductions:	
(a) Partnership income	310.92
(b) Additional gross receipts from business	48,010.41
(c) Business deductions	14,563.84
Net income as adjusted	$79,893.67

[fol. 6] Explanation of Adjustments

(a) You reported the following partnership income in an amended return filed on September 15, 1947, not included in income on the return as originally filed:

Sarfie Mesi and Bernard Petrone	$166.80
Sam Mesi and Géo. Bravos	144.12
Total partnership income	$310.92

(b) The excess of gaming receipts over gaming disbursements, or gross receipts reported by you in your income tax return for the taxable year 1946 in the amount of $43,217.65 has been increased by $48,010.41 on the basis of information on file in the Bureau and in accordance with the provisions of sections 22(a) and 41, Internal Revenue Code.

(c) The deduction for $14,563.84 explained as "Wages" has been disallowed as contrary to public policy, and as representing amounts paid to others to engage in an illegal undertaking contrary to the statutes of the State of Illinois. Accordingly, they are not ordinary and necessary business

expenses within the meaning and intent of section 23(a), Internal Revenue Code.

Computation of Tax

(Alternative Method)

Net income as adjusted		$79,783.67
Less: Excess of net long-term capital gain over net short-term capital loss		750.00
Ordinary net income		$79,033.67
Less: Exemption		500.00
Income subject to tentative tax		$78,533.67
Combined tentative normal tax and surtax on $78,533.67		$49,032.27
Tax reduction—5%		2,451.61
Partial Tax		$46,580.66
Add: 50% of $750.00		375.00
Income Tax liability		$46,955.66
Income tax liability disclosed by return	$5,129.29	
Additional assessment Aug. 11, 1950 List, Acct. No. 519042	270.56	$ 5,399.85
Deficiency in income tax		$41,555.81

[fol. 7] THE TAX COURT OF THE UNITED STATES

ANSWER TO AMENDED PETITION—Filed February 26, 1954

Comes now the Commission of Internal Revenue, by his attorney, Daniel A. Taylor, Chief Counsel, Internal Revenue Service, and for answer to the amended petition filed by the above-named petitioner, admits and denies as follows:

1, 2 and 3. Admits the allegations contained in paragraphs 1, 2 and 3 of the amended petition.

4. (A) and (B). Denies that the determination of the Commissioner is based upon the errors alleged in subparagraphs (A) and (B) of paragraphs 4 of the amended petition, or upon any errors.

A

1. Admits the allegations contained in paragraph 1 of subdivision A of the amended petition.

2 and 3. Denies the allegations contained in paragraph 2 and paragraph 3 (as corrected by motion filed January 21, 1954, granted January 22, 1954) of subdivision A of the amended petition, except it is admitted that the computation appearing on the top of page 3 of the amended petition is the same computation which appeared on petitioner's income tax return for the year 1946.

4. Admits that in the notice of deficiency respondent increased petitioner's gross receipts from his gaming business in the amount of $48,910.41 on the basis of information on file in the Bureau; denies the remaining allegation contained in paragraph 4 of subdivision A of the amended petition.

5. Denies the allegations, if any, contained in paragraph 5 of subdivision A of the amended petition.

6. Denies the allegations contained in paragraph 6 of subdivision A of the amended petition.

[fol. 8] B

1 and 2. Denies the allegations contained in paragraphs 1 and 2 of subdivision B of the amended petition.

3 and 4. Admits that petitioner, in his income tax return for the year 1946, deducted the amount of $14,563.84 as alleged wages and that said amount was disallowed by respondent in his notice of deficiency for the reason that such payments were contrary to public policy in the State of Illinois; denies the remaining allegations, if any, contained in paragraphs 3 and 4 of subdivision B of the amended petition.

5. Denies the allegations contained in paragraph 5 of subdivision B of the amended petition.

Denies generally and specifically each and every allegation contained in the amended petition not hereinbefore admitted, qualified, or denied.

Wherefore, respondent prays that the determination of the Commissioner, as set forth in the notice of deficiency, be sustained.

(Signed) Daniel A. Taylor, J.D.K., Chief Counsel, Internal Revenue Service.

Of Counsel: John D. Kiley, Regional Counsel; Gerald W. Brooks, Appellate Counsel; David H. Nelson, Special Attorney, Internal Revenue Service.

[fol. 9] THE TAX COURT OF THE UNITED STATES

STIPULATION OF FACTS—Filed March 29, 1955

It is hereby stipulated and agreed, by and between the parties in the above-entitled proceeding by their respective counsel, that the facts hereinafter stated may be taken as true and correct and accepted as evidence in this proceeding, subject to the right of either party to object to the relevancy and materiality thereof, and also subject to the right of either party to introduce other and further proof not inconsistent herewith. Exhibits referred to herein are attached hereto and made a part hereof.

1. The petitioner is an individual with residence at 1163 West Grand Avenue, Chicago, Illinois. His Federal income tax return for the calendar year 1946 was timely filed with the then Collector of Internal Revenue for the First District of Illinois. Exhibit 1-A is a photostat of petitioner's return for the calendar year 1946.

2. On September 15, 1947, petitioner filed an amended return for the calendar year 1946 which showed additional income of $310.92. Since the petitioner has consented to an assessment which has taken into cognizance the $310.92, the amended return has no bearing on the deficiency before this Court.

3. During the calendar year 1946 petitioner was engaged in the business of accepting wagers on horse races, commonly known as bookmaking, at 811 Ashland Avenue, Chicago, Illinois. Limited operations were also carried on from a handbook located at Chicago Avenue and Wood

Street, Chicago, Illinois for the first four months of the calendar year 1946.

4. The petitioner accepted bets from various individuals and agreed to pay the bettor if he won his bet such odds as were shown by the pari-mutuel machines of the various race tracks located in different parts of the country, with the limitation, that in no event would he pay more than $30.00 for $1.00, in respect of "win," $12.00 for $1.00 in respect of "place," and $6.00 for $1.00 in respect of "show." Additional limitations were 100 to 1 on daily double bets, and 15 to 1 on horses wagered on the parlay [fol. 10] bets with an over-all limitation of 100 to 1. To win a "win" bet the horse wagered on must come in first; to win a "place" bet the horse wagered on must come in first or second; and to win a "show" bet the horse wagered on must come in first, second or third. To win a daily double bet, the bettor must select in advance the winning horses in two races at a particular track, usually the first and second races. Parlay bets are similar to daily double wagers, except they may be made to win, place or show, and may be made on two or more horses at the same or different tracks. Like daily double bets the horses must be selected in advance, and all must win, place or show, depending on how they were bet to finish.

4. The petitioner had the additional limitation that he would accept no bets in excess of $100.00. The great majority of the bets taken were small, being for 50¢ $1.00 or $2.00.

5. The petitioner's income tax returns were filed on the cash receipts and disbursements basis. They were prepared by petitioner's accountant, Mr. Philip C. Corrado on the basis of the following:

(a) Bets were recorded by employees of the petitioner known as sheet writers on both betting tickets and so-called "twenty-line sheets." Each line on the sheet was numbered in sequence from 1 to 999 and the sheet itself had an alphabetical letter and color. The betting tickets were lettered, numbered, and colored to correspond with the twenty-line sheets. The sheet writer inserted a carbon paper between the betting ticket and the twenty-line sheet, and writing on the betting ticket, recorded the following information:

(1) On the extreme left the number of the horse on which the bet was placed (this number came from the hard card—see subparagraph (c) below).

(2) The bet; for example $2.00 or $5.00, and whether to win (1st blank), to place (2nd blank), to show (3rd blank), or any combination of the three. The figure or figures written in the blank or blanks, following the number of the horse on the extreme left ((a)(1)) above, represented the amount or amounts bet.

(b) The bettor took the betting ticket as his receipt and paid the amount of the wager to the sheet writer.

(c) After recording twenty bets on a given twenty-line sheet, the sheet writer turned over the sheet and the cash [fol. 11] which he had taken in exchange for the bets which he had recorded on that sheet to an employee of the petitioner known as a cashier.

(d) A large cardboard sheet, commonly called a hard card, for each track was hung on the wall in the petitioner's place of business each day. The hard card showed the entries for the day, the jockey, and probable odds. Each horse was shown by name and number and such numbers were used and written in on the safety tickets when bets were made on the various horses. (See subparagraph (a)(1) above.)

(e) The petitioner subscribed to a wire service which gave information over a loud speaker such as the time when the race commenced, the progress of the race until it ended, the result, and the odds payable at the track to the winners of win, place and show bets on the basis of $2.00 bets. A winner was required to present the original ticket to a cashier to collect his wager. When a winner presented the original ticket, it was verified against the carbon notation thereof on the twenty-line sheet retained by the cashier and if the carbon copy showed it to be a correct ticket, the notation of the amount payable for that bet according to the result at the track was entered in the last column for that bet on the twenty-line sheet and the bettor was paid according to the amount of the wager and the odds paid at the track for that race, subject to the limitations mentioned in 4 above.

Exhibit 2-B consists of twenty-line sheets showing bets written for the sixteenth of March 1946. Similar twenty-

line sheets for each day's operations were retained by the petitioner.

(f) At the close of each day, or early on the following day, the petitioner's cashier totaled the bets written according to the twenty-line sheets (i.e., the "ins") which should agree with the cash turned in to him by the sheet writer, and totaled the "outs," or amounts shown on the twenty-line sheets as bets lost by petitioner. The petitioner did not maintain a daily record of cash on hand and did not handle all receipts and disbursements through a commercial checking account at any bank. These totals together with the day's expenses for wages, stationery, rent, etc., were entered on a daily summary report. These daily reports were prepared in duplicate and one copy was sent to petitioner's accountant, Philip C. Corrado, and the other [fol. 12] retained for the petitioner. Exhibit 3-C is such a summary prepared for March 16, 1946. Exhibit 3-C is representative of the daily summary reports retained and prescribed by the petitioner for the entire period in controversy.

(g) The accountant, from the aforesaid daily reports, made a monthly summary and from such monthly summaries for the year the accountant prepared petitioner's income tax return.

6. The total "ins," the total "outs," the gross profit and the percentage of gross profit to "ins" for the year 1946 according to the total of such monthly summaries for said year are as follows:

Total Ins	Total Outs	Gross Profit	Percentage of Profit
$793,287.30	$750,069.85	$43,217.65	5.45

In the statutory notice the respondent made no change in the total reported "ins." The respondent however increased petitioner's reported gross profit by disallowing a portion of the claimed "outs." Petitioner objects to the relevancy of the percentage shown insofar as it fails to reflect scratches and returned bets.

7. In stipulating herein with respect to the nature or kind of records maintained by the petitioner and what these records show, the respondent does not admit the accuracy

or correctness of such records, nor that they are complete records of the petitioner's business for the year involved.

8. In the statutory notice of deficiency the net income as disclosed by the return in the year 1946 was increased by $58,010.41 with the following explanation:

"(b) The excess of gaming receipts over gaming disbursements, or gross receipts reported by you in your income tax return for the taxable year 1946 in the amount of $43,217.64 has been increased by $48,010.41 on the basis of information on file in the Bureau and in accordance with the provisions of sections 22(a) and 41, Internal Revenue Code."

9. At pari-mutuel racing tracks throughout the United States 10% to 17% of all bets placed is deducted for the racing association and the taxing authorities, and the remaining 90% to 83% is distributed to winning bettors. Petitioner objects to the relevancy and materiality of this statement.

[fol. 431] 10. Under 1946 Illinois statutes, Chapter 8, Sec. 37(j), racing associations kept 10% (11% where the race track was located within a county of less than 250,000 population and more than one hundred miles from the corporate limits of any city in Illinois having a population of 1,000,000 or more) of all bets placed, less 2% for taxes, plus 50% of the "breakage." For purposes of this trial it is stipulated that the breakage was 1½% of the totals wagered. The remaining 88½% (or 87½%) was distributed to the winning bettors. Petitioner objects to the relevancy and materiality of this statement.

11. No dispute exists with respect to the amount of the wage expenses incurred by petitioner in the operation of his business of bookmaking during the year involved herein, but a dispute does exist as to the propriety of the allowance of said expense as an ordinary and necessary expense under section 23(a)(1) of the Internal Revenue Code of 1939.

12. The petitioner in the conduct of his business of bookmaking paid wages to his employees in 1946 in the amount of $14,563.84. These employees performed all the services necessary in the operation of a bookmaking establishment including the recording of bets.

13. The Court may take judicial notice of section 374.1 of the Illinois Horse Racing Act and sections 336, 582 and 583 of the Criminal Code of the State of Illinois. Section 336 reads as follows:

"336. Book-making and pool-selling unlawful.

§ 1. Be it enacted by the People of the State of Illinois, represented in the General Assembly: That any person who keeps any room, shed, tenement, tent, booth, or building, or any part thereof, or who occupies any place upon any public or private grounds within this state, with any book, instrument or device for the purpose of recording or registering bets or wagers, or of selling pools, or any person who records or registers bets or wagers, or sell pools upon the result of any trial or contest of skill, speed or power of endurance of man or beast, or upon the result of any political nomination, appointment or election, or being the owner, lessee or occupant of any room, shed, tenement, tent, booth, or building, or part thereof, knowingly permits the same to be used or occupied for any of these purposes, or therein keeps, exhibits or employs any device or apparatus for the purpose of recording or registering such bets or wagers, or selling of such pools, or becomes the custodian [fol. 14] or depositary for hire or privilege, of any money, property, or things of value staked, wagered or pledged upon any such result, shall be punishable by imprisonment in the county jail for a period not longer than one year or by fine not exceeding $2,000 or both. Provided, however, that the provisions of this act shall not apply to the actual enclosure of fair or race track associations that are incorporated under the laws of this state, during the actual time of the meetings of said associations, or within twenty-four hours before any such meetings."

(Signed) Howard R. Slater, Counsel for Petitioner.
(Signed) (R. P. Hertzog, G.W.B., Acting Chief Counsel, Internal Revenue Service, Counsel for Respondent.

In the Tax Court of the United States

(Caption—50868)

Transcript of Proceedings

1212 Lake Shore Drive,
Chicago, Illinois,
Tuesday, March 29, 1955.

The above-entitled matter came on for hearing, pursuant to notice to the parties, at 10:00 o'clock a.m.

Before: Honorable Stephen E. Rice, J., Presiding.

Appearances:

Howard R. Slater, Esq., Chicago, Illinois, for the Petitioner.

Edward L. Newberger, Esq., (Hon. R. P. Herzog, Acting Chief Counsel, Bureau of Internal Revenue), for the Respondent.

The Court: You may proceed.

The Clerk: Docket Number 50868, Sam Mesi.

Statement by Mr. Slater.

Mr. Slater: If it please the court the factual issues before it this morning revolves about the gross receipts of one Sam Mesi in the admitted occupation of a handbook in the city of Chicago in the year 1946.

[fol. 15] The respondent increased the petitioner's gross receipts from his gaming ventures in the amount of some $48,000 and alleged them as notice of deficiency, that the method used in determining that the taxpayer had used in arriving at additional gross receipts was on the basis of information on file in the bureau.

To this day I still don't know what the information on file in the bureau reflects, or why. The receipts of the petitioner in this case were increased; and petitioner sets forth he has accounted for all the moneys he has taken in gross and that is likewise properly accounted for for gross reductions.

Nevertheless, we are here to show that the books kept by this petitioner were accurate, reflected all of his gross

income and that with the exception possibly of minor errors, they basically report the income for the years involved.

The stipulation which both petitioner and respondent have entered into indicates possibly that the government's case is based upon the fact that the percentage of earnings from these gross receipts was substantially less than a race track would earn on a parimutuel machine, and we have indicated in that stipulation that the percentage of earnings by a race track is irrelevant and immaterial in the case here.

Without any further ado I would like to have Mr. Corrado called.

The Court: Let us have an opening statement from the government first.

STATEMENT BY MR. NEWBERGER:

Mr. Newberger: Your honor, in addition to the issue that Mr. Slater mentioned, there is a second issue in the case which is strictly a legal issue. We have disallowed the wages paid by the petitioner on the grounds that he was engaged in an illegal activity and Section 336 of the Illinois Revised Statutes makes it a crime to pay wages to those who record bets.

We believe we cannot allow this, as to allow this expenditure would contravene public policy, and that issue in the case will be argued on that basis. We have submitted a stipulation of facts which will cover the factual issues.

As to the other point I would like to speak briefly on this for a moment. The increase of $48,010.41 in gross income is due to a disallowance by the Commissioner of petitioner's so-called pay-outs to winning bettors.

The petitioner, who is a bookie, when he receives a bet [fol. 16] records that bet as an "in"—that is, incoming bet. When a race is won and a particular horse wins, the petitioner is required to pay the winning bettor. He will list that amount as an out: that is, an outgoing payment.

Now the ins of the petitioner are his gross receipts, so you must subtract the outs of the petitioner to arrive at his gross income. We have disallowed a portion of the amounts claimed to have been paid to winning bettors. This amount was disallowed because it was unsubstantiated. The records, as presented to the Commissioner, were

not adequate for the purpose of conducting an income tax audit.

We intend to show that through evidence later at this trial. They could not be verified through any independent means. The petitioner did not maintain a bank account during the taxable years. The outs were paid in cash; there is no identification in the records of the names of the persons to whom the claimed outs were paid.

Nowhere in petitioner's records is there any indication that anything was paid for protection in spite of the fact that the petitioner ran an open bookmaking establishment. We shall introduce evidence to show that it was impossible to operate in Chicago in 1946 without protection payments. The only logical inference is the petitioner paid 35 percent or so of his profits for protection and that the outs include amounts paid for protection.

Mr. Slater: I will call Mr. Corrado.

Mr. Newberger: We have a stipulation of facts we would like to submit.

The Court: Very well; it will be received.

[fol. 17] PHILIP C. CORRADO was called as a witness by and on behalf of the petitioner, and, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name, please, and your address.

The Witness: Philip C. Corrado; I conduct an accounting business at 77 West Washington Boulevard, Chicago, Illinois.

Direct Examination.

By Mr. Slater:

Q. Mr. Corrado, are you a licensed Certified Public Accountant?

A. I am.

Q. In the state of Illinois?

A. I am.

Q. And you are still qualified to this day to conduct a certified accounting practice?

A. Yes.

Q. Were you so in 1946?

A. Yes.

Q. Were you then familiar with the petitioner, Mr. Sam Mesi?

A. Yes.

Q. Did you represent him as an accountant at that time?

A. I did.

Q. Will you briefly state to the court the services you rendered to the petitioner in this year?

A. For that year we received monthly records indicating gross receipts, gross pay-outs, expenditures itemized, net income per day. Those were the records we received together with possibly some expenses which were attached to the daily record.

From those records we recap them by the month and at the end of the year summarized them and made sure that they checked out, and computed an income tax return and executed old age-benefit tax returns which were filed quarterly.

Mr. Slater: May I have the exhibits?

The Clerk: Joint exhibits 1-A, 2-B and 3-C.

(The documents above referred to were marked Joint Exhibits 1-A, 2-B and 3-C, and were received in evidence.)

[fol. 18] By Mr. Slater:

Q. Mr. Corrado: I present you with Exhibit 1-A for identification and ask you whether you recognize same.

A. Yes.

Q. Will you state what they are?

A. This is a record for the month of January, 1946, indicating gross receipts by outs, expenditures, cash reconciliation, and an indication of whether there was a win or loss for the day.

Q. Were those sheets presented to you at the end of each month during the year 1946?

A. They were.

Q. And from those sheets you prepared a monthly report?

A. I did.

Q. Did you foot and correct them arithmetically on those sheets?

A. Yes, in fact we did. The summary sheet was necessary that it be cross footed in order that our work be complete for the month.

Q. Were the reports submitted to you in 1946 arithmetically correct?

A. As filed.

Q. And for these months you prepared an income tax return for 1946?

A. Yes.

Q. The arithmetic on that report was based upon the figures in those recaps?

A. Yes.

Q. Did you use any auditing procedures in verifying the amounts shown on these daily recaps?

A. None other than in the mathematics on the sheet itself.

Q. You did do some checking, I believe, on the expenses as listed by you?

A. Yes.

Q. What did the verification procedures as used by yourself on the expenses consist of?

A. Identifying the expenditures as listed on the daily sheet.

Q. Did you trace them back to the original invoices?

A. That would be the procedure.

Q. Did you find them to be correct?

A. Yes.

[fol. 19] Q. For how many years did you perform a similar service for Mr. Mesi?

A. Either from 1938 or 39, if my recollection is correct.

Q. When you began?

A. Yes.

Q And you went how long?

A. Possibly through 1949.

Q. Did you at any time during the course of those years find other than minor errors in the report submitted by Sam Mesi?

A. No, I did not.

Mr. Slater: Your witness.

Cross-Examination.

By Mr. Newberger:

Q. Mr. Corrado, did you make any audit whatsoever with regard to so-called outs?

A. No, I did not make the audit but I was with the examining agent for the year involved.

Q. No; the question is did you make any audit?

A. I did not, no.

Q. There was no audit made by you of the outs in the preparation of the return?

A. Not by my self.

Q. Would you, as a Certified Public Accountant, give a certified balance sheet to Sam Mosi based upon your audit?

A. No, sir, I couldn't. There were no assets involved other than the cash indicated.

Q. Did petitioner maintain a cash control account in order that he would know what his daily balance of cash on hand was?

A. Pardon me; are you asking me a question?

Q. Yes.

A. Only as indicated on the daily sheets: That is, to my knowledge.

Q. I don't understand the answer. Did you he maintain any control of his cash so that you could come in as an auditor and know how much cash he was meant to have on hand.

A. No, that was not part of my arrangement or of my service with him.

Q. Because of that it would have been impossible to audit the books. Without a cash control account you couldn't audit the books?

[fol. 20] A. For particular records?

Q. In order to audit any business accounts you certainly have to know what the cash on hand is, say, at the end of a given period. If he didn't maintain that kind of an account it would be impossible to make an audit.

A. Not necessarily. In his particular records he dealt only in cash so his record at the end of each sheet that he indicated was a running control of his cash situation.

Q. There is no indication on these sheets of any items marked cash. Will you explain to the court what you mean by that?

A. Yes; the net results at the end of the day. He took in so much money; he paid out so much money. He had so many expenses. The balance was either what he gained for the day or lost for the day.

Q. Isn't it customary for a business organization to have an account called cash, which is an important account for you as a Certified Public Accountant, at the same time?

A. The records of this type of an organization are entirely different from an ordinary business. They are dealing only with cash and they have only that item to contend with at the end of the day. Therefore, if the client knows whether he made or lost money; he has all the information he requires for the conduct of his business.

Mr. Newberger: No further questions.

Redirect Examination.

By Mr. Slater:

Q. Mr. Corrado, how many years have you been a Certified Public Accountant?

A. I received the degree of Certified Public Accountant, I believe, in 1941 or 1942. Before that I was by examination licensed to practice accounting under the state law and of which I passed the examination in 1937.

Q. You have had quite a number of years in this business.

A. I have been in the accounting business practically all my life.

Q. Let me ask you a hypothetical question: If A, a bettor, walked in to a handbook, placed his bet with an individual referred to as a sheet writer who in turn made a written record of that bet and received the cash simultaneously and thereafter after he had given number of bets on one sheet, took the sheet plus the cash that that [fol. 21] sheet reflected, and turned it over to another individual referred to as a cashier, and the cashier collected such sheets all day long and paid out to the winning bettors some of the moneys now that the cashier had, and it at the end of the day the proprietor of that establishment came in and, with you as an auditor, would you be able to verify the cash on hand at the end of the day?

A. Yes; that procedure would supply the amounts.

Q. In terms of the accounting profession, there is internal control?

A. Yes.

Q. Particularly, would this be true if we started an initial impressed fund with a given amount of cash?

A. Yes.

Q. If the cashier was given a given amount of cash each day and thereafter had sheets and cash at the end of the day, the amounts and sheets should tie up?

A. Yes.

Mr. Slater: That is all.

Recross Examination.

By Mr. Newberger:

Q. You didn't see any indication of any impressed funds or the like?

A. My duties do not require attendance in the betting room.

The Court: Answer counsel's question.

The Witness: No, I did not.

By Mr. Newberger:

Q. Would you from your examinations be able to determine whether petitioner correctly reported his ins or his outs?

A. You mean could I do that?

Q. Could you in your capacity?

A. That would be impossible.

Mr. Newberger: I have no further questions.

Redirect Examination.

By Mr. Slater:

Q. Were you asked to conduct a certified audit of this man's affairs?

A. No, I was not.

Q. All you were asked to do was to make a mathematical calculation job?

[fol. 22] A. Yes.

Q. Based upon the hypothetical situation I posed to you, had you been asked you could have an audit, could you?

A. Yes.

Q. There was sufficient data in that hypothetical question so that you could have conducted a certified audit, if need be?

A. Yes.

Q. Isn't it true you don't always conduct a certified audit for all clients?

A. Yes.

Q. In some cases you maintain some high form of mathematics rather than verification procedures

A. Of limitations,—from one extreme to the other.

Q. This includes many types of business people, does it not?

A. It does.

Mr. Slater: Thank you, Mr. Corrado.

The Court: What are those sheets on which the bets are placed? Are they part of the stipulation?

Mr. Slater: These are 365 daily recaps showing in various handwritings what was taken in and given out. We have stipulated that one day out of the year, March 16, is indicative of the entire year. We selected March 16 at random by pulling it out of a box and our stipulation states that all of these things are accepted as they are. The only question is, as Mr. Newberger put it: Have we reflected our entire gross income?

To apply the percentage of gross profit earned by a race track to the gross receipts of a bookmaker is arbitrary. We claim our books reflect our income.

Mr. Newberger: I object to the use of the term arbitrary.

Mr. Slater: It is in the petition; so you deny it.

I call Mr. Maiola.

[fol. 23] FRANK MAIOLA was called as a witness by and on behalf of the petitioner, and, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: Frank Maiola: 1859 West Chicago Avenue, Chicago, Illinois.

Direct Examination.

By Mr. Slater:

Q. Mr. Maiola, do you know Sam Mesi?

A. Yes.

Q. Did you work for him?

A. Yes.

Q. Did you work for him during the year 1946?

A. Yes.

Q. Were you a sheet writer for him during the year 1946?

A. Yes, sir.

Q. I show you agreed Exhibit 2-B, and ask you to tell the court what the top sheet is.

The Court: You asked him what a sheet writer is, did you?

Mr. Slater: No.

The Court: I don't know what that is.

Mr. Slater: I am about to explain that through this exhibit.

By Mr. Slater:

Q. What is this piece of paper?

A. It is a sheet with a carbon on top of the sheet.

Q. Is this what is called a 20-line sheet?

A. Yes.

Q. A bettor comes in and wants to bet $1 on a given horse. First of all; how does he know which horse to bet?

A. There is a hard card.

Mr. Newberger: The stipulation of facts goes into this, so that we are not solely dependent upon this man's testimony on it.

Mr. Slater: The only reason I am putting it in is to show how the money flowed through.

The Court: All right.

[fol. 24] By Mr. Slater:

Q. Is this a hard card?

A. Yes.

Q. If the bettor wanted to bet one of the numbers on this card he would give you the number?

A. Yes.

Q. What would you do then?

A. There is a carbon sheet over this sheet and there are tickets with a number on every one.

Q. Is this the ticket you are referring to (indicating paper)?

A. Yes.

Q. You put the ticket on top of the carbon paper?

A. Yes.

Q. What do you do?

A. The number of the horse, the amount of money that he wants to bet; he gives me the money and I rip the ticket off, and there is the same amount on this as on this sheet.

Q. You would have a correspondence between the line and the cards?

A. Yes.

Q. That 007 on the line there on the sheet; after you have made a number of bets——

A. We have to add it up, give it to the cashier, and it has to correspond.

Q. Does the cashier add up the amounts?

A. Yes.

Q. Who was he?

A. Leo Wolkowiez.

Q. Have you attempted to find Mr. Wolkowicz?

A. Yes; I can't find him.

Q. How many other people were doing this job you were doing as a sheet writer?

A. Two; sometimes on Saturdays, three.

Q. Name me another one.

A. Tony Jendryka.

Q. Now, the cashier had all the money at this time. What happens if one of these people who made a bet won?

A. The cashier would pay him.

Q. Did he mark anything on the sheet when he paid him off?

A. Yes, the total amount of money he paid out.

Q. On the same line where the original payment was entered, is that it?

[fol. 25] A. Yes.

Q. Now, was Sam Mesi around during this time?

A. Well, sometimes yes and sometimes no. A lot of times he wasn't around.

Q. Why?

A. He was a sick man and has been sick as long as I have known him.

Q. Did he spend a good deal of time at the race track?

A. Either at the race track or in bed.

Q. But he wasn't there normally during the course of the day?

A. No, maybe sometimes you wouldn't see him for a week and then not for a couple weeks.

Q. Did he enter these bets on the sheet himself?

A. Once in a while.

Q. Not as a usual practice?

A. No.

Q. Do you recognize the handwriting on this particular sheet you are looking at?

A. I think it is Tony's.

Q. At the end of the day what did the cashier do, to the best of your knowledge?

A. The players go home; we take the sheets and the money and then we check up.

Q. Did he prepare a daily summary from the amounts of bets and pay outs for the day?

A. Yes.

Q. Also the money he had to pay out for expenses?

A. Yes.

Q. Did you, as sheet writers, help in this work?

A. Yes.

Q. Did Sam Mesi come around for the cash?

A. Yes.

Q. Sometimes he would wait a few days and sometimes be away for a week at a stretch?

A. Yes.

Q. Did he ever act as cashier?

A. I don't think so.

Q. Did he ever sit down with you and add up the amounts on the sheet?

A. At night?

Q. Yes.

A. When he was there, yes.

Q. And if he hadn't been there for 2 or 3 days?

[fol. 26] A. We would keep the money until he came in. He trusted us.

Mr. Slater: That is all.

Cross-Examination.

By Mr. Newberger:

Q. I show you Exhibit 2-B and ask you to look at it and tell the court how much was bet on this sheet, 007-G, 1-1-007; how much money was bet?

A. $2. $1 to win and $1 to place. It shows your there.

Q. What would the winning ticket show?

A. $40.45 pay out.

Q. How much would the winning ticket indicate was bet? What would the winning ticket show?

A. It showed $1 to win and $1.45 place on a horse.

Q. I show you ticket 007-G and ask you if this ticket is the winning ticket corresponding to the 007-G on the 20-line sheet?

A. No, you couldn't pay that on this sheet because the number is only $1 to win. It is $1 to win and $1 to place on the sheet.

Q. How do you account for the fact it is a yellow ticket; it is G and marked 007, and it comes from the same day's activities as the day in question?

A. Yes. I don't know what you mean. On that ticket we can only pay him for $1 to win if it corresponds with that one.

Q. If you can only pay $1 to win, why did you mark this $1 to place?

A. Sometimes the carbon doesn't catch.

Q. How can the carbon not catch when the thing is written on the carbon and not on the original? Would it be possible after the race had been won for one of the sheet writers to have written that $1 place in?

A. I know Mr. Mesi doesn't know anything about that.

Q. Would it have been possible to do that?

A. I couldn't answer that.

Mr. Slater: I object: this man isn't qualified as an expert.

The Court: I don't think he has to be an expert to answer that question. Do you know the question?

The Witness: Yes; how come it is $1 and $1, and it is $1 on the yellow card?

[fol. 27] The Court: No, he is asking how something else came to be written in. Do you want him to ask the question again?

By Mr. Newberger:

Q. Could someone after the race is run, write in $1 here even though that would not appear on the winning ticket? Could someone take a sheet of carbon paper, put something over it and put a $1 here?

A. I can't answer that question. I have never done it and I don't know.

The Court: Of course, the answer to the question is perfectly obvious. I thought you were going to follow it up and ask if he ever did it or knew whether anyone working for Mr. Mesi did it.

The Witness: No, I never did.

The Court: Your answer is No, I take it?

The Witness: That is right.

Mr. Newberger: I offer in evidence as Exhibit 1?

Mr. Slater: I will object to the submission of evidence on cross examination. I realize that our rules of procedure in this court are somewhat relaxed but I never heard of getting in evidence during cross examination. If he sees fit to call this man as his witness, he can offer it at that time.

The Court: How about that?

Mr. Newberger: I will offer this later.

By Mr. Newberger:

Q. Let us turn to the second page. I show you a purported winning ticket and sheet numbered Yellow 6-031, which corresponds with 031 on the 20-line sheet. Will you tell the

court what the 20-line sheet indicates was bet at number 631 on same?

A. 304, $1 to win; $1 to place.

Q. I show you this ticket. Does this ticket appear to have been the winning ticket since everything corresponds except that this ticket does not indicate anything bet to win?

A. That is right.

Q. How do you account for the fact that the carbon shows $1 bet to win, whereas the winning ticket itself shows nothing under a block marked to win?

A. That isn't my writing; I don't know.

The Court: What was your answer? I didn't hear it. [fol. 28] The Witness: I know I have been with the man for a long time; I never saw anything like that before.

The Court: Well, your answer is you can't explain it.

The Witness: No, I can't.

By Mr. Newberger:

Q. I will skip a few pages and now come to a sheet labeled on the top: M-Yellow-33. Will you take a look first at the hard card for that day and the bets placed under item 652 and compute how much the winner was entitled to? Do you want some scratch paper?

A. I can't figure parlays.

Q. You can't figure parlays?

A. No; I am not a cashier. I just write bets.

Q. I turn to another sheet: M-Yellow-34. Will you take a look at the first 9 or so horses there and tell the court which race that came from?

A. Do you want me to pick out which

Q. You see horses 1, 3, 8, 11. Will you tell the court do they come from the first race, the third race or what?

A. No, 1 is the first race.

Q. The first race where?

A. Sometimes the hard card puts different tracks.

Q. The first race?

A. No. 1.

Q. How do you account for the fact that in the middle of the page where they purported to be?

A. Big winner.

Q. They suddenly jump to the 8th race.

A. I will tell you about that.

Q. Tell the court.

A. You come in early in the morning and want to make a wager and don't want to stay; you can bet 6 or 7 races and the first race.

Q. You can what?

A. You can bet the last race and come in at post time at 1 o'clock, and perhaps he wants to make a wager in the last race,—so much on a certain number at Tropical in the last race.

Q. Is it unusual to have some in the middle and just one on the first race, but some bets in the 6th or 7th races; before the first race was over?

Mr. Slater: I object. This man isn't familiar with those records at all.

The Court: I can give him the answer.

[fol. 29] The Witness: I did give him the answer.

The Court: I asked you another question.

Mr. Slater: See if you can find another sheet where they bet the 7th or 8th race before the 1st race was over.

The Witness: Maybe I can find sheets. There is 37 going up to 213. Those are later races. They bet the 2d race. I believe that is the 2d or 3rd race.

By Mr. Newberger:

Q. What kind of bet is this, with the 213?

A. That is a parlay; that is a later race.

Mr. Newberger: I have no further questions of this witness.

Redirect Examination.

By Mr. Slater:

Q. Suppose I am a milkman and I walk into the place.

A. Yes.

Q. And I want to bet half a dollar on each of 8 races, and I put down $4 and I pick out 8 horses in 8 different races.

A. Yes.

Q. Do you write them one after another?

A. On the same sheet.

Q. The sheets I showed you and the government's attorney asked you about; are they in your handwriting?

A. Not the one he showed me.

Q. Do you recognize the handwriting?

A. There were three or four sheet writers there. I don't know it.

Q. Who made the pay outs?

A. The cashier.

Q. In whose handwriting is the pay out?

A. The cashier's.

Mr. Slater: No more questions.

Recross Examination.

By Mr. Newberger:

Q. I have one or two questions. Mr. Maiola, you wrote these bets out on so-called 20-line sheets and they were all numbered?

A. Yes.

Q. Will you explain to the court how you got hold of the 20-line sheets, who gave them to you, and what system was used in giving them to you?

[fol. 30] A. Who gave me the sheets?

Q. Yes.

A. We get them from the printing company.

Q. Did you go to a cupboard and take them out? Explain that.

A. They come in bundles, in lots.

Q. For example, if you were writing them you stick to a steady rotation. In other words, if you were writing sheet G-001 yellow, then you go on from G-001 all the way up so that you have G-002 next; G-003 next until you had used up the series 001 to 999; would that be the custom? You start out with a bundle, G-001, the next would be G-002, and I notice these are numbered on from 001 to 999. Would you use one number continuously until you start with another color; that is, would you use one color and then another, I meant to say; is that the system?

A. You have two or three sheet writers. Everybody doesn't write on the same sheet.

Q. For a given day's operations the sheets should be numbered consecutively, shouldn't they?

A. You have sheets left for the next day too. We don't throw them away. We use them. They might have different initials. Do you get my point?

Q. No.

A. No? All right.

Q. On one day's operations wouldn't be logical to use a consecutive series of numbers 001 on up to 999 even if you yourself maybe had one third of those sheets, wouldn't it be logical for the other writers to have a sequence?

A. Sometimes you have a mistake in the books too.

Q. Not frequently?

A. Well—

The Court: What counsel is asking is: What was the customary practice? Did each sheet writer go consecutively?

The Witness: Sometimes they do. Sometimes when we are busy we each take a— They run by alphabets and we each take a set and sometimes when there are some left we start out the next day with it.

By Mr. Newberger:

Q. This particular day shows at least 5 or 6 different sets being used. How do you account for that many sets being used in one day?

[fol. 31] A. Sometimes you have four or five sheets from one book and 2 or 3 sheets from another book, and we use them up, but you have to put the same numbers here that you do on there (indicating cardboard card), no matter what kind you use.

Q. Was there any control so that someone could tell the disposition of all these 20-line books?

A. You mean whether Mr. Mesi knew about it or what?

Q. If there was no control it would be possible for Mr. Mesi to throw away one of the books; say he had—

Mr. Slater: I will object to the inference.

A. I never—

By Mr. Newberger:

Q. Was there any control kept?

A. I don't know what you mean was there any control kept.

Q. Who handed you the 20-line sheets?

A. We had them there; the cashier used to give them to us.

Q. Did the cashier keep a record of what he gave you?

A. No, he didn't keep any record.

Q. There was no record kept of what you were given?

A. No.

Redirect examination.

By Mr. Slater:

Q. Where did you buy the 20-line sheets?

A. Lawton's.

Q. How many at a time?

A. Two or three sets at a time.

Q. What do you mean by sets?

A. The whole alphabet.

Q. You bought 2 or 3 sets at one time?

A. To the joint.

Q. Who was there to accept delivery?

A. Whoever was.

Q. Was Sam there?

A. He wasn't even there.

Q. Who paid for them when they brought them in?

A. I would pay him and Sammy would give me the money or I would tell him, or something else.

Q. You start out with 3 sets all numbered from A through Z?

A. Yes.

[fol. 32] Q. Suppose we have a brand new set and nothing left over from the other day, and suppose you have three sheet writers working. You came in for work, Tony came in, and a third man came in.

A. We each took a book.

Q. Any book you wanted to?

A. Yes.

Q. Did you use us all the books before you bought new one?

A. We didn't wait until we were completely out.

Q. When you saw you were running low you bought a new batch?

A. Yes.

Q. Did anybody count the books at the end of the day to see that all books were accounted for?

A. Which books?

Q. Suppose you took it into your head to make some money off Sam and you took a whole set of books and you kept your own pay off without paying to the cashier?

A. You couldn't.

Q. Why not?

A. We are all seated together there when you turn in the book.

Q. Who did you turn the books in to at the end of the day?

A. The cashier.

Q. Who did you turn in the sheets to when you made your report to Sam Mesi?

A. The cashier.

Mr. Slater: That is all.

(Witness excused.)

The Clerk: Call your next witness.

Mr. Slater: Mr. Jendryka.

[fol. 33] ANTHONY JENDRYKA was called as a witness by and on behalf of the petitioner, and, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: Anthony Jendryka: 1839 Iowa, Chicago, Illinois.

Direct examination:

By Mr. Slater:

Q. Mr. Jendryka, do you know Sam Mesi, the petitioner?

A. I work for the man.

Q. Did you work for the man during 1946?

A. Yes.

Q. Were you a sheet writer during that year?

A. Yes.

Q. You worked the entire year?

A. Yes.

Q. Were you paid a salary for this?

A. Yes.

Q. Did you hear the questions asked of Mr. Maiola and the answers he made?

A. Yes.

Q. Do you disagree?

A. No, that is the truth.

Q. A bettor would come in, and you would record the bet on the line and turn the sheets over to the cashier at the end of the day?

A. Yes.

Q. At the end of the day you all sat down and compared with the cashier the entire day's play?

A. Yes.

Q. Or it would be discussed with Sam Mesi?

A. Yes.

Q. All of these sheets were used with 2 or 3 there?

A. Yes.

Q. Was there always somebody watching everybody else?

A. Yes.

Q. Was Sam doing any of this writing?

A. Once in a great while you would see him.

Q. Did any of the people at the place make their bets through this book?

[fol. 34] A. No.

Q. Did you make bets through the book?

A. No.

Q. Did anybody else over there?

A. No.

Q. Did Sam Mesi book his bets?

A. No.

Q. If he did do any betting, to the best of your knowledge, where did he do it?

A. At the track.

Q. Earlier in the day you heard the government state we had to pay out at least 35 percent of our money in order to get protection. Were there ever any police in your place?

A. No.

Q. Except when you were raided?

A. That is the only time we would see them.
Q. How many times were you raided?
A. Possibly 5, 6, 7 or 8 times.
Q. What happened then?
A. They arrested us or we would call Sam Mesi or call a bondsman and go trial the next day.
Q. Who paid for the bondsman and the lawyers?
A. Sam Mesi did.
Q. Do you know how he paid for it?
A. Out of his own pocket, I guess.
Q. Did it ever show up as an expense on the books here?
A. No, sir.
Q. So far as you know?
A. No.

Cross-examination.

By Mr. Newberger:

Q. The last witness stated he thought these first few sheets were in your handwriting, is that correct?
A. No, sir; that is not in my handwriting.
Q. I show you the first sheet of Exhibit 2-B, and you see horse 304 listed at 007 on sheet G, in yellow -1, will you tell the court what was indicated by that?
A. It is 304, $1 to win and $1 to place.
Q. I show you the winning ticket correspondingly numbered and ask you to explain to the court why the winning ticket doesn't show $1 to place.
A. The only thing may be that the cashier made a mis- [fol. 35] take. There are a lot of times the bettor will come up and say: $1 to win on a horse, or may change his mind and write: $1 win, $1 place. Maybe he didn't put it on here but did on the bet.
Q. I didn't think the cashier made a bet.
A. No, but the bettor may have changed his mind and instead of $1 to win, bet $1 and $1 and the cashier didn't put it on the ticket but put it on the sheet.
Q. What happened to 031 on this sheet?
A. $1 win, $1 place.
Q. I show you a winning ticket corresponding to that

line and ask you to account for the fact that there was nothing indicated on the win block.

A. That I could not explain.

Q. Let me return to the first page and I again call attention to 007; does it appear to you that the 1 written in under this place (indicating on document) is considerably darker than all the other carbon figures on the page?

A. The only possibility is like I said; he must have written it in. The player must have changed his mind and wanted $1 and $1, instead of $1 to win on it.

Q. Or it could have been written in after the race?

A. I have never seen it done.

Q. It could have been?

A. It could have been but I have never seen it done.

The Court: Let me see if I am following your theory, Mr. Newberger. These assumptions that you are making, am I correct in understanding that if this had happened, that these marks were placed on here after the bet had been made it would tend to indicate that there were more pay outs than there actually were; is that what you are trying to prove?

Mr. Newberger: It would tend to indicate he padded his pay outs to show less profits.

The Court: That he made less pay outs than he actually did?

Mr. Newberger: Opposite to that. He showed pay outs but in fact they were fictitious entries, and that he did not, in fact, pay them out.

The Court: All right, continue.

By Mr. Newberger:

Q. I show you Exhibit 2-B, sheet M-Yellow-33, line 652, on which there were bets placed apparently on horses 213 and 223. Will you look at the hard card for that day [fol. 36] and tell the court how much a winner should collect on said bets?

A. That I don't know. This one right here are you talking about?

Q. This one (indicating on document).

A. That is a parlay. I am not much acquainted with parlays.

Q. You don't know how to figure that out?

A. No.

Q. Do you know whose handwriting this winning ticket No. 652 is in?

A. I know it isn't mine.

SAM MEST was called as a witness by and on behalf of the petitioner and, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: Sam Mest; 1163 Grand Avenue, Chicago, Illinois.

Q. Isn't it true that because you didn't pay such protection you were hounded and forced to move from your place of business to the garage and back to your place of business?

A. Yes.

Q. Because you wouldn't make payments?

A. Yes; I didn't see any reason to.

Q. Why didn't you make payments?

A. I didn't see any reason to.

Q. Could you afford it?

A. I didn't see any reason to.

Q. Did anybody approach you for that protection?

A. None that I saw approaching me.

Q. Were you arrested at any time during 1946 for this booking operation?

A. No, sir.

Q. Are any of those summary reports in your handwriting?

The Court: Are those the 365 summary sheets?

Mr. Slater: That is right.

[fol. 371] The Court: Don't you know where you made them?

The Witness: I made them occasionally but he asked me for these here.

By Mr. Slater:

Q. Well, let us pass that. Isn't it fairly sure you didn't make more than a handful during the course of a year?

A. Maybe 10 or 12.

Q. I show you Exhibit 2-B. Is that in your handwriting? Here is the summary report for the day of the sheets you are looking at? Is the summary report of that day in your handwriting?

A. No.

Q. Whose handwriting is it in?

A. It should be in the cashier's, I believe.

Q. Mr. Mesi, for how many years have you been a horse bettor?

A. I have been betting horses ever since I can remember.

Q. Are you fairly familiar with the techniques of placing a bet on a horse?

A. Yes.

Q. Explain why it is possible for a race track to make 14 percent net on their bets and you conceivably would earn zero, or lose money.

A. If you read the records and the Form, it shows what percentage the race track takes.

Q. They have a guaranteed take under the law?

A. Yes; some tracks take 12 to 14; sometimes as high as 18 percent.

Q. The law permits them to do this?

A. That is their law.

Q. You pay off on race track odds?

A. Yes.

Q. Do you have a completely balanced book like the race track does?

A. No.

Q. Isn't it true that some of your people may have been only on the winners so that you could end up losing money for the day?

A. That is possible. You have to have more winners than losers, in order to lose.

Q. Isn't it true during 1946 you had many days in which you ended up with a net loss in the betting for the day?

[fol. 38] A. On the summary?

Q. Yes.

A. Yes.

Q. And that such losses are correctly reported on these sheets?

A. Right.

Q. What was the average type of bet you received at your place?

A. Here (indicating on document): $1, $2, half a dollar, $3 to win, $3 to win, $5 and $5.

Q. Those horizontal lines,—show them to the court.

A. 50 cents win, $1 to show.

Q. Show that to the court. The horizontal line reflects 50 cent bets?

A. 50 cent bets; and here is $1.

Q. Did you ever receive any large bets, $1,000, for example?

A. No.

Q. What was your average bet?

A. $1, $2, 50 cents, $3, $5.

Q. The type of people who were betting with you, what type of people were they?

A. Working class, a few business people.

Q. They would stop in on their way to work and place some bets?

A. That is right.

Q. When did they collect?

A. That night; maybe the next day.

Q. If they showed up the next day, how did you show it on your summary sheets?

A. If they did not collect a bet,—you see, like this? That means that the party didn't collect that bet. They would put that in an envelope and the next day the party would come in with that ticket numbered that way, and they would get that envelope.

Q. Other than Wolkowiez have you had any other cashier?

A. Since 1946, no.

Q. Have you been able to find him?

A. No.

Q. Do you have any reason to think he would cheat you out of any money?

A. I trust them all.

Q. So far as you know he didn't cheat you of anything?

[fol. 29] A. No.

Q. There was an inference that conceivably pencil writ-

ings could be put on these sheets after the race was done so that you could pad your pay outs. I ask you as to 007-G-Yellow, did you pad that entry yourself?

A. No.

Q. Is it possible for a 20-line sheet to be already in the cashier's hands and the bettor change his mind and want to increase the bet?

A. Yes.

Q. Would the cashier necessarily do it on the ticket of the bettor?

A. I trusted the cashier and if you went up there with a ticket and you had changed your mind about the bet you made and you wanted to change it; he was authorized to do it.

Q. Without bothering with anybody?

A. Without bothering with anybody.

Q. How often did this happen?

A. Maybe you won't have one for a week and maybe on the same day you would have 9 or 10 occasions of that kind.

Q. Mr. Mesi, I take it you were acquainted during the year 1946 with at least some of your customers, were you not?

A. On sight.

Q. Do you know any of them?

A. By name?

Q. Yes.

A. I remember one fellow; he was a doctor.

Q. What was his name?

A. I can't even think of his name. He went into the army.

Q. Out of all the customers you had that year, and you must have had hundreds, you can't recall one name?

A. This is 1955. 1946 is 9 years ago. If you do not see people for 9 years I don't think you will remember them either. I know I don't.

Q. During the year you operated did you then know the name of any of your customers?

A. Very few because I wasn't there that long to get acquainted with them. Most of the time I went there in the evening.

[fol. 40] Q. Did you ever lay off any bets?

A. No, sir.

Q. Did the policeman on the beat near your place of operations ever visit you, ever speak to you?

A. If I went past him I would wave to him; he didn't speak to me.

Q. Did you ever pay him anything?

A. No.

Q. At Christmas time?

A. No.

Q. Did you make any political contributions in the year 1946?

A. No.

Q. Did you maintain a bank account for this operation?

A. No, sir.

Q. Did you have any inventory control of the 20-line sheets used in the operations?

A. Did I have control of them?

Q. Inventory control so that the men would get them in a set sequence?

A. No, sir.

Q. How could you tell whether some of them were missing or not?

A. I never checked to that effect.

Q. You never checked?

A. No.

Q. How did you keep the cash that was used to operate this business?

A. What do you mean, keep the cash?

Q. There was no bank account; tell the court what system you used.

A. Here is the system I used. I gave them $300 for a bank loan for operating expense and at night time if I went there, say if they won $100, I would take a recap and $100, and they would still have $300 for the next day. And if they lost I would reimburse them their losses.

Q. Mr. Mesi, are you familiar with computing wins and losses for salaries and the like?

A. Yes.

Q. I show you Exhibit 2-B, Sheet M-Yellow-33, 652.

A. That is a daily double.

Q. That is all right. You are familiar with computing daily double bets?

A. Yes.

Q. Will you look at the hand card and tell the court [fol. 41] how much this person should have won betting on horses 213 and 223?

A. $95.

Q. How do you compute that? Horse 213 in the first race won what?

A. It paid $8.60.

Q. So how much would be riding on the daily double?

A. The other horse paid $16.40.

Q. And how do you compute $95 out of that?

A. We don't compute it. That is what the race track paid, $95 for the daily double.

Q. This first horse paid $8.60 for $2, right?

A. Right.

The Court: Are you shifting from a daily double to a parlay? He has testified to a $95 figure for the daily double.

Cross-examination.

By Mr. Newberger:

Q. How do you know it is a daily double and not a parlay?

A. Do you see this "d" here?

Q. Mr. Mesi, do you see on this sheet we have here M-Yellow-33, carbon marks? Can you see, faintly, carbon marks?

A. No, sir. Here is another thing. You know these sheets,—how old they are.

Q. I show you the following page, M-Yellow-34, entry 671 in which horse 114 apparently won. Will you look at the hand card and tell us what the winnings should be?

A. 114 paid $19.60.

Q. And how much would the win be?

A. $88.

Q. How do you figure that?

A. For $20 it would be $196.

The Court: What are you back on now, the parlay?

Mr. Newberger: No, this is a different bet.

The Witness: This is a different bet.

By Mr. Newberger:

Q. I will ask you to figure that out again. How much should the winner have received on horse 114 bet at entry 671 on the 20-line sheet?

A. $98.

Q. And what is written on here?

A. $88.

[fol. 424] Q. Didn't the winner holler for that extra $10?

A. I don't know. If I had been there, I would have known.

Q. Mr. Mesi, how do you explain the irregularity in these 20-line sheets?

Mr. Slater: I object to the conclusion that there is an irregularity.

The Court: Well, rephrase the question. Ask him to explain what you want him to explain.

By Mr. Newberger:

Q. Mr. Mesi, on t heceni2s0es-ishet fTh5-bLh

Q. Mr. Mesi, on these 20-line sheets you go from G-4-Yellow to G-6-Yellow, and then, for example, you jump to 11.

A. G-4 to G-6.

Q. You say G-4, 2, 3, 4, 5 and 6, and then you jump to 11. How do you account for that?

A. It is possible that the day before they may have been working on these, and a different sheet writer was working, and they maybe had that book and finished up on it.

Q. Why did they jump then to M-Yellow-10?

A. This is 11, 10 is here (indicating).

Q. Why do you jump to M?

A. Maybe they took a different series. Do you find any more G-Yellows?

Q. No.

A. That is probably it. They probably finished the book the day before. If there are 2 or 3 sheet writers they have each a different book.

Q. As you go into the yellow series, Yellow-M's, and you go from 10 and then you jump all the way to 38, how do you account for that?

A. They may have been working on that the day before.

Q. Then you go from 32 to 39 and jump another letter to K; how do you account for that?

A. They probably grabbed those books. As you get all these sheets you will find they all follow each other, you understand; say you get that whole month's supply—they will follow each other.

Q. But there was no system in the day to day's use. Judging from these simple entries they would take them hit or miss.

A. They would take them and grab them as they came.

Q. Did you personally ever check to ever see that all the sheets were on hand for any given period of time?

[fol. 43] A. You mean did I check them and see that they had?

Q. Yes.

A. No.

Mr. Newberger: I have no further questions.

Redirect examination.

By Mr. Slater:

Q. Were your books of account examined by an Internal Revenue agent for 1946?

A. Yes.

Q. Was that man's name Prehn?

A. William Prehn.

Q. Did he discuss the results of his examination with you?

A. Yes.

Q. What did he say as to the condition of your books and records?

A. At that time I had all the bills and he said everything was in order with the exception of some items I didn't have any bills for.

Q. Did he disallow those items?

Mr. Newberger: I object, as hearsay.

Mr. Slater: It is not hearsay. He happens to be an agent for the respondent. I can produce him. This is an admission against interest and I don't think it is hearsay when he presents a report. All I have to elicit is what he admitted to my client.

The Court: You are not going to call him?

Mr. Newberger: No.

The Court: Then I will overrule your objection. Go ahead.

By Mr. Slater:

Q. What did he state about your books?

A. He said everything was in order with the exception of some items I didn't have any bills for.

Q. Did he disallow those items?

A. Yes.

Q. Did you pay a deficiency for those items?

A. Yes.

Q. They are not involved today though?

A. No.

Q. Inference after inference has been made by the government that you have distorted these records and withheld money for yourself for your own purposes and conceivably used them for yourself for your own purposes and conceivably used them for protection purposes. I ask you did you do so?

[fol. 44]

A. No.

Q. The government fixed upon three different lines——

Mr. Newberger: This is testimony, not speeches.

Mr. Slater: I am not making speeches.

By Mr. Slater:

Q. (Continued.) The government picked out three lines showing a bettor had paid for a win and place bet whereas the ticket only showed a bet to place.

Another showed where a bettor had been underpaid on his winnings. Another shows where he had been paid off on a bet to win but had made a bet for win and place. You state this could have occurred after a bettor stepped up to the cashier and added to his original bet?

A. Yes.

Q. Were you ever present when those things took place?

A. No.

Q. To the extent a bettor had been underpaid you profited by that, did you not?

A. Right.

Q. But you didn't take off the total amount as would have been paid him, or, rather, that he should have been paid, on your tax return, but you only took off what he was actually paid?

A. Yes.

Mr. Slater: I have no further questions.

Mr. Newberger: I have no further questions.

The Court: You testified on direct examination this place was rented about 6 times in 1946?

The Witness: Yes.

The Court: And some of your employees were arrested?

The Witness: Yes.

The Court: And you were never arrested during 1946?

The Witness: No.

The Court: Did the police know you owned that business?

The Witness: They were always looking for me. They wanted to arrest me.

The Court: Did they know you?

The Witness: If they saw me?

[fol. 45] The Court: Yes.

The Witness: Yes, some knew me. Not all of them.

(Witness excused.)

Mr. Slater: I have no further testimony. That, plus the stipulation, constitutes the petitioners' case.

Colloquy Between Court and Counsel

The Court: Let me ask you: you had 2 or 3 winning tickets there. What was it,—3 that you showed these various witnesses?

Mr. Newberger: At least 3 or 4.

The Court: Where you thought they had been changed somewhat.

Mr. Slater: The tickets themselves weren't changed.

The Court: There were additional entries on the carbon?

Mr. Slater: Yes, which aren't reflected on the 20-line ticket.

The Court: Let me know, do you have a bunch of those, a great many, or is that all you have?

Mr. Newberger: We have taken only one day to exemplify this case, March 16 as representative. We have not

made any attempt whatsoever to go through any of the record other than March 16, so we are only going to show the ones we have shown so far.

The Court: Does the stipulation take care of that? What I am trying to find out is: Are there a great many of these or are these the only ones?

Mr. Newberger: These are the only ones because we both have stipulated we agreed that this day is representative of all the days.

Mr. Slater: It is representative in the sense that it reflects the method of bookkeeping used by the petitioner in this case.

The Court: You are leaving me up in the air.

Mr. Slater: I don't know whether it represents a percentage of error represented by these three tickets. I didn't know there were any errors. We selected these at random. There are boxes that could go up to the ceiling.

The Court: You mean for just 1946?

Mr. Slater: That is right. These were examined by the Revenue agent named Prena. He presumably found them in order. For the purposes of our stipulation respondent and I agreed we would put our hand in the box and pull out one day.

The Witness: Tell me what that means.

[fol. 46] Mr. Slater: I am not going to stipulate that this percentage of error took place every day in the year. I don't know that to be the case. All I will stipulate is, and do stipulate to, is the methods used were used every day in the year but I don't say these three tickets are indicative of a method in which they are inconsistent in themselves.

Mr. Newberger: Do you think the data is representative for all the year or do you think we took a year which is not representative.

Mr. Slater: The theory of the petitioner's case is very simple. Our theory of the petitioner's case is very simple. Our theory is that our books are substantially correct. No, I couldn't contend they are 100 percent correct. The stipulation was worded that way. All I attempted to show is that the books were substantially accurate and substantially did reflect what took place.

To the extent respondent tries to show the records were meaningless, I will not agree that they were.

The Court: What is your idea?

Mr. Newberger: To take one day. If we were to take more than one day I would have the agents go through these records and obviously many things would be found there, in a few pages.

Mr. Slater: I don't think it is obvious. I do know it was done and a report was made on it. No change was recommended except minor errors.

Mr. Newberger: Changes were made.

Mr. Slater: And I still don't know what that information is, Mr. Newberger.

The Court: You are familiar with the revenue agent's report?

Mr. Slater: Certainly.

The Court: Aren't you aware that there were a great many more of these irregularities or there were not? It has to be one way or another.

Mr. Slater: I say he happened to find these.

The Court: I am asking Mr. Newberger.

Mr. Newberger: The agent assigned to me yesterday came up with a few errors and the only reason one day was used was because I understood and agreed with Mr. Slater to take one day as representative.

Mr. Slater: I don't know what his idea was. The stipulation was entered into to take one day as representative.

Mr. Newberger: If this day isn't considered representative, we are going to have to go through all these records. [fol. 47] Mr. Slater: It seems to me you have had several years in which to do so, that you have already availed yourself of the opportunity.

Mr. Newberger: The records were only made available during the last week.

Mr. Slater: No, in 1948, 1950, 1951; they were gone into in great detail in the office of Mr. Corrado who was here and testified. I am sorry I didn't speak to him or the revenue agent; and that the agent gave him a pass. The only thing discussed was that this man's percentage of gross on bets was lower than the race track percentage. At no times was it suggested that there were errors in his bookkeeping until this morning.

Mr. Newberger: We haven't accepted his books.

Mr. Slater: But you haven't indicated why you haven't accepted his books.

Mr. Newberger: The outs have not been substantiated.

The Court: Insofar as you have mentioned the three tickets, or whatever it is, the inference is against you that you were trying to prove by it that possibly somebody came in and changed their bets.

Mr. Slater: Would you simplify it if I agree it is representative of the entire year?

The Court: It would, on my part. It has been worrying me ever since the respondent brought it up. I think that would be very important. If it is only three, that seems to me sort of against the government's proposition.

Mr. Slater: Do you have anything more to enter into at this time? The government has had me in surprise for four years and I think I should know what they are going to do.

Mr. Newberger: The most we are going to deal with is 4 or 5 and most of them have been covered.

Mr. Slater: Then I will stipulate the entire year is represented by this one day.

The Court: What is that again, Mr. Newberger?

Mr. Newberger: In our further testimony the most errors we will show will be possibly five, in the review we have covered. There may be others; I am not certain.

The Court: Similar to the ones you have had testimony on?

Mr. Newberger: Yes.

The Court: Go ahead.

[fol. 48] NORMAN HANDELSMAN was called as a witness by and on behalf of the petitioner, and, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: Norman Handelsman, 2735 West Sunnyside, Chicago, Illinois.

Direct examination.

By Mr. Newberger:

Q. With whom are you employed?

A. The Internal Revenue Service.

Q. What is your work?

A. Internal Revenue agent.

Q. How long have you been an Internal Revenue agent?

A. Since 1946.

Q. State your educational background.

A. I am a graduate from the University of Illinois College of Commerce; I hold the degree of Certified Public Accountant, and I am a member of the bar of the state of Illinois.

Q. Have you any accounting experience other than that which you have had as an Internal Revenue agent?

A. Yes.

Q. You state you are a Certified Public Accountant?

A. Yes.

Q. Will you state for the court briefly what an audit is?

A. An audit is an examination of books and records of an organization to determine its financial position at a given date, and the results of its operations for a certain stated period.

Q. Would you state what the purpose of an audit for income tax purpose is?

A. If the audit is made by the Internal Revenue Service its purpose is to determine whether or not the net income reported on the taxpayer's return is actually the correct net income.

Q. Have you examined any of the records maintained by this taxpayer?

A. Yes.

Q. Have you an opinion as to the adequacy of the taxpayer's records?

[fol. 49] A. Yes.

Q. That opinion is for the purpose of conducting an income tax audit?

A. Yes.

Q. Will you state what that opinion is?

A. My opinion is you cannot make an income tax audit of these records.

Q. Will you tell the court the reason for that opinion?

A. The reliability or the accuracy of these records can not be verified through any independent means. It is impossible to determine whether or not the amounts actually paid out, the amounts indicated as pay outs have actually been disbursed by the petitioner.

There is no way of determining whether these amounts have actually been paid out.

Q. So when you say there can be no substantial you are referring to the fact that there is no way of substantiating the outs?

A. Yes; the government must accept the records as submitted because there is no independent means of verification.

Q. As a Certified Public Accountant would you be required—what books and records a taxpayer must maintain to satisfy the Internal Revenue Code?

A. Yes.

Q. What sections in the old Code indicate that, do you know?

A. I believe they are Sections 41 and 54.

Q. I guess you are required to know that as an Internal Revenue Agent?

A. Yes.

Q. Do the records of this petitioner satisfy that?

A. No, they do not satisfy 41 and 54.

Mr. Slater: I object.

The Court: Overruled.

By Mr. Newberger:

Q. In making satisfactory audit of a bookmaker, what information and records would be required?

A. I think you must have the name and address of each payee in order to determine whether the outs have actually been paid out.

Q. Do you think it is necessary to have an inventory control of the 20-line sheets?

A. Yes, I do.

[fol. 50] Q. Tell the court why.

A. If there is no inventory,—I wil put it on a negative basis; for example, in this particular case here, the sheets are not submitted in sequence so that a sheet writer or the proprietor can eliminate an entire group of sheets indicating bets placed and there would be no way of determining whether these sheets have been withdrawn and the amounts excluded from the taxable income reported.

If there is an inventory control and the sheet writer or proprietor must account for each single set it is possible

by inventorying these sets to determine whether or not each bet which has been reported has been returned as reported income on the return.

Q. You didn't mention the need for a cash control. Would you say without some form of cash control account it would be possible to audit a taxpayer like Mr. Mesi?

A. All the cash account does is it is of additional assistance in conducting an audit and in a cash business like a bookmaking business, without some control over the cash there is no way of tying in the amounts reported at the ends of the day with the payment sheets indicating the bets of the player.

Q. I show you Exhibit 2-B and turn to page M-Yellow-33, specifically number 652. Do you see on this section to the right of 652 any carbon imprint?

A. Well, I see an imprint in the column above 652 indicating where the previous safety ticket laid at the time the previous bet was placed. There is a line here indicating where the previous ticket was placed. I think we have some blank safety tickets which would indicate how that operates. These are the blank safety tickets, when the bettor places win, place and show bets. There is a carbon underneath. This carbon leaves an imprint after each ticket is marked.

Q. I show you Exhibit D.

(The document above referred to was marked Respondent's Exhibit D for identification.)

By Mr. Newberger:

Q. I show you Exhibit D; is this a typical 20-line sheet?

A. Yes.

Mr. Newberger: I offer this in evidence as Respondent's Exhibit D, as representative of 20-line sheets in general.

[fol. 51] Mr. Slater: I object. It is a typical 20-line sheet already in the record.

Mr. Newberger: This is a typical 20-line sheet not used.

Mr. Slater: We have stipulated about each and every item. Secondly, that new one is a little different than the one over here; thirdly, it is made in 1953 and not in 1946. On all of those grounds I would object.

The Court: You are just trying to offer it to prove the carbon marks?

Mr. Newberger: I am only introducing it for the witness to testify about the carbon marks. I don't think it is necessary. It is purely offered for clarification purposes. It has not intrinsic value in itself.

The Court: Go ahead. I will accept it. It is received in evidence.

(Thereupon the document heretofore marked respondent's Exhibit D was received in evidence.)

By Mr. Newberger:

Q. Mr. Handelsman, I show you Exhibit D. With the aid of this exhibit do you think you could explain to the court a little bit more about these carbon marks you were trying to explain before?

A. These safety tickets here leave an imprint underneath the carbon. This is the equivalent of your pegline sheet here, leaving an imprint showing where the safety ticket left off. This one was right on this line and this one right above it so that this safety ticket down here commences, the top of the safety ticket, approximately even with this line, and that this safety ticket ends approximately even with this line. They don't always run in lines like this.

Q. But you can tell from the carbon where a saf ticket ends?

A. That is right.

Q. On the basis of that, will you show the court what you would state with regard to this particular winning ticket, 652-M?

A. These records were presented to me yesterday afternoon, and going through there on this rather large bet I noted there was a different handwriting here, that the one previous to this, 651, seems to be similar to the one on 652.

Mr. Slater: I would like to interrupt his testimony. [fol. 52] The gentleman has been qualified as a Certified Public Accountant. I made no objection. I don't see where he is a handwriting expert or an expert on safety tickets.

The Court: Your objection is well taken. That is, as to the testimony on different handwriting.

A. (Continued.) There is a carbon line equivalent to the line drawn on here which commences right here which would mean this safety ticket at the time it was listed on the 20-line sheet, laid on the 20-line sheet in this manner, to put the top carbon here; can you see it?

The Court: Yes, I can see it.

A. (Continued.) When you raise this up you will see that this upper is quite a bit higher than the two under the imprint, which leaves the indication that this safety ticket was not written at the same time and in the same sequence as it should be written,—651, 652 and 653.

Mr. Slater: I will object to that.

The Court: Wait just a minute. Why do you say it wasn't written at the same time?

The Witness: Because, as I say, since if this was even here, this top of the line would indicate——

By Mr. Newberger:

Q. Before being torn off, before being detached?

A. In other words, this 651 and 653 were written in sequence and 652 was not and that 652 was written at a period subsequent to 653 rather than in a sequence of 651, 652 and 653, because if it was written at the same time the imprint left with this carbon line would be exactly even, laying on the 2, and as such we have approximately one-sixteenth of an inch or so difference in the carbon imprint.

The Court: Unless the ticket had been canted a little bit when it had been written. I don't know that you can draw a definite opinion from that. That is your opinion, of course. Go ahead.

Mr. Newberger: That is all of my questions.

Cross-Examination.

By Mr. Slater:

Q. If the book was slightly irregular and the tickets were placed together, and please keep in mind that the safety book used in the 1946 case is somewhat different than the one you are talking about,—if it was irregular and placed a little improperly, would you still get a different imprint?

[fol. 53] A. This ticket would have to be even with this line.

Q. Suppose they were all pushed up?

A. Then this line would not be where it has.

Q. It has nothing to do with the tickets?

A. These lines always run in sequence, that if the ticket is written as it is now, this 2 would have to be in absolutely the same position as the 2 on the carbon sheet of the 20-line sheet. If this 2 was laid even it would indicate it was not written at the same time.

Q. What is the total payment of that page?

A. $108.30.

Q. $108.30?

A. Yes.

Mr. Slater: I will renew my objection to his testimony and the conclusion on this evidence.

The Court: All right; I will overrule you on that.

By Mr. Slater:

Q. There is a petty cash impressed fund?

A. A petty cash impressed fund is a fund maintained that has the same amount of cash at all times. You add to the fund if the fund needs additional cash; or, if it has a larger amount, you will withdraw it.

Q. I think you will agree that that wouldn't satisfy the Certified Public Accountant examination.

A. I gave you a definition of the petty cash impressed fund.

Q. Let us say the petty cash impressed fund consists of $100 and I turn it over to my petty cashier and I tell my petty cashier: You can spend this money for certain purposes. You can also take in money because you would be cashing checks, etc. but at the end of the day I want you to turn over all your receipts and what you have paid out plus whatever cash you have paid out and at the end of the day I leave with what is over $100 and if she has less than $100, I build her up to that. Is that a petty cash impressed fund?

A. Yes.

Q. Where is this different from this bookie, where he started with $300 and at the end of every day he took

away everything he had more than $300 and, if less, he built it up?

A. There is no total indicating the dates.

Q. You have the dates?

[fol. 54] A. You asked me a question and are interrupting before I have finished.

Q. Go ahead.

A. From the testimony I heard, this individual did not go to this place every day to collect the funds, so there must have been a running total at various times indicating how much was paid over by the cashier or whoever handled the funds. There is no indication of the dates and amounts.

Q. Where individuals who had no interest in this business who were working for daily wages and daily sat down with the cashier who didn't appear, summarized the day's operations, and when Mesi came around they gave him summaries for two days. Do you audit that, Mr. Handelsman, or do you not?

A. No; I say you cannot make an audit for that.

Q. Do you mean to tell me Sears Roebuck sets up a petty cash fund, they can't audit it?

A. When their payments are made, the names and addresses appear.

Q. Suppose the names didn't appear but there are, say, receipts by individuals who swore to it, would that constitute a petty cash fund?

A. Would you repeat that?

Q. Suppose you have sworn receipts for every nickel in cash signed for by people that swore to it, that is, what they have had daily, that this is what they had at the end of the day, and the rest is paid over to the petitioner?

A. All I can say is that there isn't an audit if there isn't independent verification.

Mr. Slater: This man testified he is a Certified Public Accountant. Let him give me an accounting conclusion.

A. (Continued.) I will say this that there isn't a certified public accountant in the city of Chicago who will give you a certified balance sheet or certify as to the accuracy of the bookmaker.

By Mr. Slater:

Q. Do Certified Public Accountants accept certificates for certain things?

A. Yes.

Q. What do they accept certificates for?

A. For an inventory.

Q. What else?

A. For a statement from a bank.

[fol. 55] A. What else?

A. Accounts receivable.

Q. And all we have done is gotten somebody to say under oath that this is what it is, isn't that the case?

A. I don't know whether it is under oath.

Q. It doesn't have the juridical safeguards we have here today?

A. That is true.

Q. You got two individual people get on the stand and swear it was turned over to Sam Mesi.

A. You are asking what an accountant would say.

Q. From that could you say whether you could certify an audit?

A. No.

Q. Did you check the accuracy of these reports?

A. Yes.

Q. Did they check?

A. A few errors in the calculation of winning bets.

Q. Were those substantial?

A. Well, if I had the safety tickets——

Q. Were they substantial?

A. No, not in large amounts.

Q. You would insist as a Certified Public Accountant where I have an independent opening balance and cash, I have a closing independent balance and cash, and I have sworn receipts, that I don't have a petty cash impressed fund for an audit?

A. I wouldn't say that.

Q. Do we or don't we have an impressed fund?

A. We have an impressed fund only in method of handling.

Q. Is an impressed fund subject to a certified audit?

A. Yes.

Mr. Slater: That is all; your witness.

Redirect Examination.

By Mr. Newberger:

Q. I don't think the court has completely understood the testimony with reference to this ticket M-652. I would like to ask you a few more questions. If you take a ticket, a ticket is placed over the 20-line sheet, is that not correct? That is the way the book is formed?

A. Yes.

Q. And there is a carbon in between, is that correct?

A. Yes.

[fol. 56] Q. And you can see if you look at it closely that there is a mark,—the carbon leaves a mark indicating on the 20-line ticket, the exact dimensions of the cardboard cover ticket, is that correct?

A. Yes.

THE TAX COURT OF THE UNITED STATES

SAM MESI, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 50868

Findings of Fact and Opinion—December 16, 1955

1. Petitioner operated an illegal bookmaking business in 1946. His records and income tax return for that year disclose a gross profit of 5½ per cent on the total bets received. Respondent accepted the accuracy of the reported gross receipts and operating expenses but determined that petitioner had overstated the amounts paid to winning bettors. Respondent disallowed $48,010.41 of the wagering losses claimed by petitioner. This amount was arrived at by increasing the percentage of gross profit earned by petitioner to 11½ per cent on the basis that 11½ per cent of the amounts bet at the pari-mutuel machines at certain race tracks in Illinois was retained for the benefit of the racing association and the tax authorities. *Held*, the gross profit earned by petitioner bears no relation to the percent-

age retained out of amounts bet at pari-mutuel machines, and respondent's determination is excessive. However, because of petitioner's failure to explain certain discrepancies in his records, it is *Held, further*, that he overstated deductible wagering losses by $5,000 on his return for 1946.

2. Petitioner paid wages aggregating $14,563.84 to employees in his illegal bookmaking business during 1946. The payment of the wages, in and of itself, constituted an illegal act. *Held*, such payments violated the clearly-defined public policy of the State of Illinois and are not deductible as ordinary and necessary expenses under section 23(a) (1)(A) of the 1939 Code.

Howard R. Slater, Esq., for the petitioner.
Edward L. Newberger, Esq., for the respondent.

[fol. 57] This proceeding involves a deficiency in income tax determined against Sam Mesi (hereinafter referred to as petitioner) in the amount of $41,555.81 for the taxable year 1946.

The issues to be decided are: (1) whether petitioner overstated the amounts paid to winning bettors in reporting the gross income from his bookmaking business; and (2) whether the amounts paid by petitioner as wages in the conduct of his illegal bookmaking business are deductible as ordinary and necessary business expenses under section 23 (a)(1)(A) of the 1939 Code.

Some of the facts were stipulated.

Finding of Fact

The stipulated facts are so found and are incorporated herein by this reference.

Petitioner resided in Chicago, Illinois, during the calendar year 1946 and filed his Federal income tax return for that year with the collector of internal revenue for the first district of Illinois.

During the year 1946, petitioner was engaged in the business of accepting wagers on horse races, commonly known as bookmaking. Petitioner operated his gambling business from three or four different locations at various times during that year. He had a principal location for which he paid an annual rental, but he was compelled to move about because of raids by the police. He operated

from garage and even in basements, hallways, and alleyways during certain periods in 1946.

Petitioner spent very little time at his bookmaking establishment during the daytime. He occasionally visited it in the afternoon and usually went there in the evenings when the summaries of the day's activities were being prepared. Although engaged in an illegal business and although his establishment was raided several times during 1946, he was not personally arrested at any time during that year.

Petitioner's gambling business was an extensive one. Although the great majority of the bets taken were small, being for $.50, $1.00 or $2.00, and though no bets in excess of $100.00 were accepted, incoming bets totaled $793,287.50 in 1946. He employed six or seven persons during that year, paying them gross wages in the amount of $14,563.84. [fol. 58] Among these employees were a cashier, two or three sheet writers who accepted and entered the incoming bets, men on the "hard cards," and a doorman. The "hard cards" were large cardboard sheets, one for each track, which showed the entries for the day, the jockey, and the probable odds. Each horse was shown by name and number and such numbers were used in designating the horses on the betting tickets. Petitioner subscribed to a wire service which broadcast racing news over a loud speaker, such as the time when a race commenced, the progress of the race until it ended, the result, and the odds payable at the track to the winners of "win," "place," and "show" bets.

Petitioner paid winning bettors according to the odds shown by the pari-mutuel machines at the race tracks with a limitation that in no event would he pay more than $30 for $1, in respect of a bet to "win," $12 for $1, in respect of a bet to "place," and $6 for $1, in respect of a bet to "show." Certain additional limitations were imposed on daily double bets and on parlay bets.

Bets were entered by the sheet writers on small, printed cardboard tickets, approximately 1½ by 5 inches in size. Each ticket bore an alphabetical and numerical designation in addition to its identifying color. The tickets were attached in groups of 20 to sheets of paper approximately 5 by 13½ inches in size, which are called 20-line sheets. The tickets were arranged and attached, in numerical sequence, in such fashion that each of the 20 tickets was

directly over a line bearing a number corresponding to that on the ticket. Series of these sheets and tickets were bound together in book form and purchased, as they were needed, from a local supplier. When entering a bet, the sheet writer would insert carbon paper between the betting tickets and the 20-line sheet and simultaneously record on the ticket and the 20-line sheet the amount of the bet, whether the bet was to "win," "place," "show," or any combination of the three, and the code number which indicated the track, race, and name of the horse on which the bet was placed. The amount of the bet was then paid to the sheet writer and the betting ticket was detached and given to the bettor as his receipt. After recording 20 bets on a given 20-line sheet, the sheet writer turned over the sheet and the cash taken in with respect to the bets recorded on that sheet to the cashier employed by petitioner.

The sheet writers obtained their books of betting tickets [fol. 59] and 20-line sheets from the cashier. Such books were not necessarily used in alphabetical or numerical sequence. The cashier maintained no inventory or running record of unused books, or of tickets received, on hand or disposed of.

A winner was required to present his ticket to the cashier in order to collect his wager. When presented, it was verified against the carbon copy on the 20-line sheet possessed by the cashier. If the carbon copy showed it to be a correct ticket, the amount payable for that bet, according to the result at the track but subject to the limitations enforced by petitioner, was entered on the 20-line sheet immediately adjacent to the carbon notation of the bet and the bettor was paid in cash by the cashier. No receipts were obtained from the bettors and petitioner's records do not disclose their identities.

At the close of each day or early on the following day, petitioner's cashier totaled the bets written on the 20-line sheets, referred to as the "ins," and also totaled the bets shown on such sheets as having been paid off by petitioner, which were termed the "outs." These totals, together with the day's expenses for wages, stationery, rent, and other incidentals, were entered on a prepared form known as a daily summary report. The daily summary reports were prepared in duplicate and one copy was set to peti-

tioner's accountant and the other retained for petitioner.

At various times during the year, petitioner's accountant prepared a monthly summary on the basis of the daily summary reports which had been submitted to him. He prepared petitioner's income tax return for the year 1946, on the cash receipts and disbursements basis, from such monthly summaries. No audit was made to determine the accuracy of the "ins" and "outs" reported on the summaries, and petitioner's accountant stated that there was no method of verifying the total amounts received and paid out by petitioner. The total "ins," the total "outs," the gross profit and the percentage of gross profit to "ins," for the year 1946, according to such monthly summaries and petitioner's return for that year, are as follow:

Total Ins	$793,287.50
Total Outs	750,069.85
Gross Profit	$ 43,217.65
Percentage of Profit	5.45

[fol. 60] Petitioner's records for March 16, 1946, were stipulated to be typical of his records for the entire year 1946. The records for this one day disclose that, in two instances, the winning tickets bore a notation indicating only a bet to "win" or a bet to "place," where as the 20-line sheets indicated that these two bets had been made for both "win" and "place." Payments on such bets were made according to the 20-line sheets.

In the statutory notice of deficiency, respondent made no change in the reported "ins." Respondent, however, increased petitioner's reported gross profit by $48,019.41 by disallowing a portion of the claimed "outs." This increased the percentage of gross profit on total receipts from 5.45 per cent to 11.5 per cent.

At pari-mutuel racing tracks throughout the United States, an amount ranging from 10 to 17 per cent of all bets placed is deducted for the benefit of the racing association and the tax authorities. The remaining 90 to 83 per cent of the amounts bet is distributed to winning bettors. Under the laws of Illinois for the year 1946, either 88½ or 87½ per cent of the amounts bet at pari-mutuel tracks was distributed to winning bettors, depending upon the location of the race track.

The services performed by petitioner's employees in return for wages constituted a violation of section 336 of the Criminal Code of the State of Illinois, and the payment of the wages, in and of itself, constituted an illegal act.

Petitioner overstated the amounts paid out to winning bettors by $5,000 on his return for the year 1946.

Opinion

Rice, *Judge*: This is another in a long series of cases involving the question of whether a bookmaker had accurately reported the income derived from his illegal gambling business. As in many of the previous cases, the respondent does not contest the accuracy of the gross receipts and operating expenses reported by the taxpayer, but has determined that the taxpayer overstated the wagering losses realized in his business and, consequently, understated his income. The first issue which we must decide, therefore, is whether petitioner is entitled to claim as a deduction the amounts shown on his records as having been [fol. 61] paid to winning bettors, in computing the income earned from his bookmaking business in 1946.

In the instant case, the petitioner has supposedly maintained and preserved for the respondent's inspection a complete file of his original records. These records, more specifically, the 20-line sheets, do not identify any of the bettors, but they seem to contain an accurate listing of the amounts received and the amounts paid out with respect to every bet. Daily and monthly summaries of these 20-line sheets were compiled, and, on the basis of such summaries, petitioner's return for the year here in issue was prepared. The mathematical accuracy of such summaries, and of petitioner's return, has not been questioned.

Petitioner's records and income tax return disclose total receipts from wagers amounting to $793,287.50 in 1946, and a gross profit on such wagers of approximately 5½ per cent Respondent contends that since approximately 11½ per cent of the amounts wagered at pari-mutuel tracks in Illinois is retained for the benefit of the racing association and the State, and since the amount retained at pari-mutuel tracks throughout the United States ranges from 10 to 17 per cent of all bets placed, petitioner's re-

ported gross profit for the year 1946 should have been 11½ per cent of the total wagers received. Therefore, in order to increase petitioner's gross profit from 5½ per cent to 11½ per cent, respondent has determined that petitioner overstated the amounts paid out to winning bettors in the aggregate amount of $48,010.41.

The essence of respondent's argument is that petitioner must be presumed to have paid between 35 and 50 per cent of his net profits for protection from police interference with his illegal activities. Respondent contends that such nondeductible expenses must have been entered and concealed on petitioner's books by entering fictitous losses and by padding the amounts paid to winning bettors, thus resulting in a gross profit of but 5½ per cent. Respondent has, therefore, disallowed the deduction of $48,010.41 of the wagering losses claimed by petitioner for lack of substantiation.

Respondent introduced the testimony of the Chief Investigator for the Chicago Crime Commission, an independent citizens' organization, to the effect that bookmakers cannot operate in Chicago unless they pay for protection. However, petitioner was unequivocal in his testimony that he did not make any payments for [fol. 62] protection. The fact that other gamblers in Chicago may have been required to do so is of no evidentiary force with respect to any such payments made by petitioner. We do not know what petitioner's relations with the "criminal syndicate" were or why he may have been able to remain in business without paying for protection. But, in any event, the record indicates that petitioner's activities were not completely free from police interference. His wagering establishment was raided several times and petitioner was compelled to change his location and even operate from alleyways and a garage during the year 1946. We have consequently been unable to find as a fact that petitioner made any protection payments during that year.

We recognize the difficulties facing respondent in attempting to audit the records of a taxpayer who is engaged in an illegal business and where the identity of his customers is not ascertained and recorded. Petitioner's own accountant testified that there was no way in which the accuracy of the 20-line sheets could be verified as to the amounts received from and the amounts paid out to bet-

tors. Moreover, petitioner's records were susceptible of easy manipulation. Lines on the 20-line sheets could be left blank until the end of the day, and, after all the races had been run, petitioner could then enter fictitious bets on losing horses and retain such fictitious losses for his own personal use. In addition, since no control was maintained over the sequence in which the alphabetically and numerically coded 20-line sheets were used, those sheets disclosing few or no losses could be removed from the file of petitioner's records and the net receipts disclosed by such sheets could be pocketed by petitioner.

Our system of income tax collection relies on individual self-assessment. Taxpayers are required to file returns setting forth their income, their deductions, and a self-computed tax. The self-assessment system would be unworkable unless means were provided whereby the accuracy of the self-determined tax could be checked. The Regulations,[1] therefore, provide that each individual must [fol. 63] keep such books and records as are sufficient to establish the individual's gross income. The mere mathematical accuracy of such records is insufficient; they must clearly reflect the taxpayer's income.

The issue of whether petitioner's records accurately reflect his income for the year 1946 is one of fact, to be decided on the basis of all the evidence in the record. *Jack Shouse*, 23 T. C. 495 (1954), on appeal C. A. 9, March 9, 1955. Respondent contends that, since petitioner's records do not permit the verification of the various payments made to winning bettors, he may determine the amount of

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[1] Regulations 111.

Sec. 29.54-1. Records and Income Tax Forms.—Every person subject to the tax, except persons whose gross income (1) consists solely of salary, wages, or similar compensation for personal services rendered, or (2) arises solely from the business of growing and selling products of the soil, shall, for the purpose of enabling the Commissioner to determine the correct amount of income subject to the tax, keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of the gross income and the deductions, credits, and other matters required to be shown in any return * * *.

deductions permitted to petitioner for such unsubstantiated expenditures under the rule of *Cohan* v. *Commissioner*, 39 F. 2d 540 (C. A. 2, 1930). However, although petitioner has failed to carry his burden of proving that the total amount claimed to have been paid to winning bettors was, in fact, so paid, we find respondent's determination of such amount to be excessive. Respondent has determined that $48,010.41 of the losses claimed by petitioner must be disallowed because his reported gross profit amounted to but 5½ per cent whereas the pari-mutuel machines in the State of Illinois operated on a gross profit of 11½ or 12½ per cent, depending upon their location. But, petitioner's winnings or losses have no relation whatsoever to the amount retained out of bets placed at pari-mutuel tracks. The evidence shows a lack of relation between the percentage of winnings in the petitioner's business and the amount retained at pari-mutuel tracks. The amount retained out of bets placed at such tracks is a mathematical amount established by law. The elements of chance and skill have but slight effect on the profits earned by such tracks. They could rarely lose, whereas petitioner might easily suffer substantial net losses from a day's betting if he accepted a disproportionate number of bets on winning horses. *Cf. H. T. Rainwater*, 23 T. C. 450 (1954). The mere suspicion on the part of the Commissioner that the petitioner's records do not accurately reflect his correct income is not sufficient reason to justify adoption of the Commissioner's percentage of winnings in the face of the evidence in this case which shows it is excessive.

The parties have stipulated that petitioner's records for one day during the year 1946 are to be considered typical of his records for that entire year. The records for that day, as submitted into evidence, disclose that in at least two instances the amounts entered on the 20 line sheets as having been paid to winning bettors were larger in amount [fol. 64] than the amounts properly payable for such bets according to the betting tickets. Petitioner failed to explain such discrepancies adequately and, thus, to overcome respondent's determination that his claimed losses were overstated. On the basis of this record and bearing heavily on the petitioner, who failed to keep records with adequate controls and information subject to verification, *And*

Shargel, supra, we have found as a fact that petitioner overstated his deduction for wagering losses on his return for 1946 by the amount of $5,000. *Cohan v. Commissioner, supra*.

The second issue herein is whether petitioner is entitled to deduct, as ordinary and necessary business expenses, wages amounting to $14,563.84 which he paid to the various employees who aided him in the conduct of his illegal bookmaking business during 1946. In his deficiency notice, respondent has allowed the deduction of the various operating expenses claimed by petitioner except for the wages here in issue. Respondent contends that these wages are the "illegitimate expenses of an illegitimate business" and that to allow their deduction would frustrate sharply-defined public policy.

It has long been accepted that certain deductions are not allowable for public policy reasons, although there is no specific provision in the Code or Regulations to that effect. Thus, deductions have been denied for fines and penalties incurred for violation of Federal and State statutes, *Burroughs Bldg. Material Co. v. Commissioner*, 47 F. 2d 178 (C. A. 2, 1931); *Great Northern Ry. Co. v. Commissioner*, 40 F. 2d 372 (C. A. 8, 1930), certiorari denied 282 U. S. 855 (1930); *Julian Lentin*, 23 T. C. 112 (1954), affd. ——— F. 2d ——— (C. A. 7, October 14, 1955); *Joseph Saltzman*, 21 T. C. 777 (1954); *Henry Watterson Hotel Co.*, 15 T. C. 902 (1950), affd. 194 F. 2d 539 (C. A. 6, 1952); for bribes paid to public officials, *Frank A. Maddas*, 40 B. T. A. 572 (1939), affd. 114 F. 2d 548 (C. A. 3, 1940); for expenses incurred for certain types of lobbying engaged in to influence Federal legislation, *Textile Mills Corp. v. Commissioner*, 314 U. S. 326 (1941); and for legal expenses incurred in connection with the unsuccessful defense of criminal actions, *C. B. Thomas*, 16 T. C. 1417 (1951); *Anthony Carmen Stralla*, 9 T. C. 801 (1947).

The frustration of public policy rule has served as the basis for the disallowance of loss deductions under section [fol. 65] 23 (e) and 23 (f) as well as the disallowance of "ordinary and necessary" business expenses under section 23 (a) (1) (A). Thus, in a recent decision, a foreign corporation doing business within the United States was refused a loss deduction, on public policy grounds, for property

which had been vested with the Attorney General as enemy alien property under the Trading with the Enemy Act. *U. S.* v. *Algemene Kunstzijde Unie, N. V.*, ——— F. 2d ——— (C. A. 4, September 19, 1955). In *G. E. Fuller*, 20 T. C. 308 (1953), affd. 213 F. 2d 102 (C. A. 10, 1954), a loss deduction was denied for merchandise confiscated by the State because it had been illegally held for sale.

It has frequently been stated that, where fines and penalties are involved, their deduction as ordinary and necessary business expenses must be disallowed, for to do otherwise would have the effect of possibly frustrating governmental policies by reducing the impact of the penalty. See *Commissioner* v. *Longhorn Portland Cem. Co.*, 148 F. 2d 276 (C. A. 5, 1945), certiorari denied 326 U. S. 728 (1945); *Dauenshire, Inc.*, 12 T. C. 958 (1949). Another line of cases in this area states the rule that though some business expenditures may be "ordinary and necessary" in the generally accepted meanings of these words, when they violate Federal or State law, thus frustrating sharply defined National or State policies proscribing particular types of conduct, they are not deductible as ordinary and necessary expenses under section 23 (a) (1) (A) of the 1939 Code. *Gallatin Farmers Co.* v. *Commissioner*, 132 F. 2d 706 (C. A. 9, 1942); *Boyle, Flagg & Seaman, Inc.*, 25 T. C. ——— (Filed October 18, 1955). See *Israel Silberman*, 44 B. T. A. 600 (1941); *Easton Tractor & Equipment Co.*, 35 B. T. A. 189 (1936); *Lorraine Corporation*, 33 B. T. A. 1158, 1166 (1936). As stated in *National Brass Works* v. *Commissioner*, 182 F. 2d 526, 530 (C. A. 9, 1950): "It is true that neither the tax statute nor the treasury regulations condition deductibility upon the lawful character, either directly or remotely, of the expenditure made. * * * But, in the nature of things, public policy must narrow the field of allowable deductions which rest as they do upon legislative indulgence." In two cases which have been before the Supreme Court, that Court has indicated its acceptance of this principle although, in both of these cases, no violation of a clearly defined public policy was found to exist. See *Lilly* v. *Com-*
[fol. 66] *missioner*, 343 U. S. 90 (1952); *Commissioner* v. *Heininger*, 320 U. S. 467 (1943).

This Court has previously considered the question of whether one engaged in an illegitimate business may deduct

the legitimate expenses of such business and, on the facts of that case, held that such expenses were deductible, *G. A. Comeau*, 10 T. C. 203 (1948), affirmed sub nom. *Cohen v. Commissioner*, 176 F. 2d 394 (C. A. 10, 1949). However, the fact that an expenditure is directly related to the production of income does not automatically qualify it as deductible. Where the expense itself is inherently contrary to public policy its deduction must be disallowed. Although both the instant case and *G. A. Comeau*, *supra*, involve the deductibility of wages paid to employees in an illegal bookmaking establishment, the instant case is clearly distinguishable. The record in this case establishes that the payments in question constituted the illegitimate expenses of an illegitimate business, whereas no such finding of fact was made in *G. A. Comeau*, *supra*.

Section 336 of the Criminal Code of the State of Illinois, as quoted below, not only makes the conduct of a bookmaking establishment illegal but also provides that employees who assist in the conduct of such business by recording bets are equally guilty of the commission of an illegal act.

> Illinois Revised Statutes 1945 (Burdette Smith).
>
> 336. * * * That any person who keeps any room, shed, tenement, tent, booth or building, or any part thereof, or who occupies any place upon any public or private grounds within this State with any book, instrument or device for the purpose of recording or registering bets or wagers, or of selling pools, or any person who records or registers bets or wagers, or sells pools upon the result of any trial or contest of skill, speed or power of endurance of man or beast, or upon the result of any political nomination, appointment or election, or being the owner, lessee or occupant of any room, shed, tenement, tent, booth or building, or part thereof, knowingly permits the same to be used or occupied for any of these purposes, or therein keeps, exhibits or employs any device or apparatus for the purpose of recording or registering such bets or wagers, or selling of such pools, or, becomes the [fol. 67] custodian or depository for hire or privilege, of any money, property, or thing of value staked, wagered or pledged upon any such result, shall be punish-

able by imprisonment in the county jail for a period not longer than one year, or by fine not exceeding $2,000 or both. Provided, however, that the provisions of this act shall not apply to the actual enclosure or fair or race track associations that are incorporated under the laws of this state, during the actual time of the meetings of said associations, or within twenty-four hours before any such meetings.

In addition, section 582 of the Criminal Code of the State of Illinois provides as follows:

Illinois Revised Statutes 1945 (Burdette Smith).

582. * * * §2. An accessory is he who stands by, and aids, abets or assists, or who not being present, aiding, abetting or assisting, hath advised, encouraged, aided or abetted the perpetration of the crime. He who thus aids, abets, assists, advises or encourages, shall be considered as principal, and punished accordingly.

Pursuant to these sections of the Criminal Code of the State of Illinois, the payment of the wages in question in and of itself constituted an illegal act. The wages paid by petitioner were paid to procure the direct aid of others in the perpetration of an illegal act, namely, the operation of a bookmaking establishment. Certainly, it would be a clear violation of public policy to permit the deduction of an expenditure, the making of which constitutes an illegal act.

We recognize that the disallowance of the instant expenditure may be almost tantamount to taxing petitioner on his gross rather than his net income. But it is axiomatic that deductions are a matter of legislative grace. *New Colonial Co.* v. *Helvering*, 292 U. S. 435 (1934); *Deputy* v. *du Pont*, 308 U. S. 488 (1940); *Detroit Edison Co.* v. *Commissioner*, 131 F. 2d 649 (C. A. 6, 1942), affd. 319 U. S. 98 (1943). Whether a taxpayer's business is a legal or an illegal one, it is inconceivable that he should be permitted a deduction for amounts spent to procure the commission of an act outlawed by a State statute. We, therefore, hold

that petitioner is not entitled to deduct the wages paid to his employees during the year 1946.

Reviewed by the Court.

Decision will be entered under Rule 50.

[fol. 68] DISSENTING OPINION

MURDOCK, *J.*, dissenting: Many cases involving income and deductions of illegal businesses come before the Court, but this is the first one to my knowledge in which the Commissioner has disallowed a deduction for wages of regular employees claimed by an employer who is engaged in an illegal business. The Commissioner in many cases refuses to accept the net income shown on the books and records of an illegal business because the petitioner has destroyed the original records and the Commissioner has no way of verifying the accuracy and completeness of the books. The Commissioner here has disallowed the salaries of employees who made the original records which the Commissioner properly deems essential to a complete set of records and upon which he has relied in determining the total amounts bet. The Court is supporting him in this, and thus the expense of keeping the very records which are essential to a correct reflection of incor . is denied as an ordinary and necessary expense of the business.

These employees are engaged in the perpetration of the same crime through which the principal earns the income in question. Their wages, like rent, heat, light, telephone and supplies, such as paper and pencils, are inherent expenses of the business, indispensable to the earning of the income in question. Rent and telephone expense would fall into the same category as these wages, if the landlord and the telephone company knew that gambling was conducted on the premises. To deny such deductions is to tax, to that extent, gross income. *G. A. Comeaux*, 10 T. C. 201, 207, affd. 176 F. 2d 394. *Cf. Commissioner* v. *Heininger*, 320 U. S. 467. Wages of real employees are different from bribes in that the giving of a bribe is a separate offense from the conduct of the illegal business. *G. A. Comeaux*, *supra*.

The allowance for wages should be the same in every

state, but here the deduction is being disallowed because of a specific statute of the State of Illinois.

I think the deduction should be allowed.

TIETJENS and ATKINS, *JJ.*, agree with this dissent.

[fol. 69] THE TAX COURT OF THE UNITED STATES

DECISION—Entered Feb. 9, 1956

Pursuant to the determination of this Court, as set forth in its Findings of Fact and Opinion filed December 16, 1955, the respondent filed a computation for entry of decision on February 2, 1956. The petitioner having noted his acquiescence therein, it is

Ordered and Decided: That there is a deficiency in income tax for the taxable year 1946 in the amount of $10,887.77.

(Signed) Stephen E. Rice, Judge. (Seal.)

Entered Feb. 9, 1956.

IN THE UNITED STATES COURT OF APPEALS

(Caption—50868)

PETITION FOR REVIEW (MESI CASE)—Filed Apr. 24, 1956

The petitioner on review, Sam Mesi, hereby petitions the United States Court of Appeals for the Seventh Circuit to review the decision entered by the tax court of the United States on the 9th day of February, 1956, ordering and deciding that there is a deficiency for the year 1946 in respect of the income tax liability of Sam Mesi who is the above named petitioner on review.

Sam Mesi is an individual taxpayer who filed his income tax return for the year 1946, the taxable year here involved, with the Collector of Internal Revenue for the First District of Illinois, whose office is located within the jurisdiction of the United States Court of Appeals for the Seventh Circuit, wherein this review is sought.

The petition for review was filed pursuant to the pro-

visions of Sections 7482 and 7483 of the Internal Revenue Code of 1954.

Dated this 19th day of April, 1956.

Howard R. Slater, Attorney for Petitioner on Review, 134 N. LaSalle St., Chicago 2, Illinois.

[fol. 70] IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

[Title omitted]

STATEMENT OF POINTS

Now comes Sam Mesi, Petitioner on Review, by his attorney, Howard R. Slater, and makes the following statement as grounds for and in support of his Petition for Review by the United States Court of Appeals for the Seventh Circuit of the decision of the Tax Court of the United States rendered in the above entitled cause on February 9, 1956, and hereby asserts the following errors which he intends to urge on review:

The Tax Court of the United States erred in the following respects:

(1) In holding and deciding that there is a deficiency in income tax for the taxable year of 1946 in the amount of $10,887.77.

(2) In failing to order and decide that there is no deficiency in income taxes of the Petitioner on Review for the taxable year 1946.

(3) In holding and deciding that the rentals paid by the Petitioner on Review for the use and occupancy of various leased premises for the acceptance of wagers, and the wages paid employees employed by the taxpayer in the operation of a "handbook"—a gambling establishment—did not constitute allowable deductions under Section 23 (a) (1) (A) of the Internal Revenue Code of 1939.

(4) In holding and deciding that the payments made for rents and wages contravene public policy and that the allowance of them would frustrate public policy and

are contrary to the law and regulations promulgated thereunder.

(5) In failing to hold and decide that the payments made for wages are ordinary and necessary in that the [fols. 71-72] taxpayer was compelled to hire employees in order to maintain the records demanded of him for the purposes of making and declaring a correct income tax return pursuant to Section 54 of the Internal Revenue Code of 1939.

(6) In that in its decision and opinion the Tax Court disregarded the overwhelming weight of the evidence which clearly reflected that the taxpayer had correctly represented the gross receipts received by him from wages and the gross disbursements made by him to winning wagerers.

(7) In holding and deciding that the Petitioner on Review overstated his deduction for wagering losses on his income tax return for 1946 by the amount of $5,000.00.

(8) In holding and deciding that the rule of *Cohan* v. *Commissioner* applies to disbursements made for wagering losses.

(9) In failing to hold and decide that the books and records maintained by the Petitioner on Review for the year 1946 substantially and correctly reflected the results from his operations of a gambling establishment during the year 1946.

(10) In that its opinion and decision are not supported by, but are contrary to, the evidence and the facts as shown by the record of the trial hereof.

(11) In that its decision and opinion are contrary to law and the Commissioner's regulations.

Respectfully submitted, Howard R. Slater, Attorney for Petitioner on Review, 134 N. LaSalle St., Chicago, Illinois.

[fol. 73] Clerk's Certificate to foregoing Transcript (omitted in printing).

[fol. 74] In the United States Court of Appeals for the Seventh Circuit, September Term, 1956, January Session, 1957

No. 11775

Sam Mesi, Petitioner,

v.

Commissioner of Internal Revenue, Respondent

On Petition for Review of the Decision of the Tax Court of the the United States

Opinion—April 5, 1957

Before Duffy, Chief Judge, and Swaim and Schnackenberg, Circuit Judges

Schnackenberg, Circuit Judge:

Sam Mesi, hereinafter referred to as the taxpayer, by his petition asks us to review a decision of the tax court which decided that there is a deficiency in his income tax for the year 1946 in the amount of $10,887.77. The tax court made findings of fact and rendered an opinion.[1]

During the year 1946, taxpayer was engaged in the business of accepting wagers on horse races, commonly known as bookmaking. He had a principal location for which he paid an annual rental. Incoming bets totaled $793,287.50 in 1946. He employed 6 or 7 persons during that year, paying them gross wages in the amount of $14,563.84. Among these employees were a cashier, 2 or 3 sheet writers who accepted and entered the incoming bets, men on the "hard cards," and a doorman. The total ins, [fol. 75] the total outs, the gross profit and the percentage of gross profit to ins, for the year 1946, according to monthly summaries kept by the taxpayer and his return for that year are as follows:

Total ins	$793,287.50
Total outs	750,069.85
Gross Profit	$ 43,217.65
Percentage of Profit	5.45

[1] Reported in 25 T.C. 513.

As interpreted by respondent, the tax court determined "that the wages paid to employees in taxpayer's illegal gambling enterprise were not deductible since the payment of the wages violated the criminal statutes of Illinois and the deduction of such wages would tend to frustrate the declared public policy of that state."

The tax court disallowed $5,000 of the betting losses claimed by the taxpayer.

1. The tax court erroneously failed to allow as deductions wages proved to have been paid by taxpayer to his employees in carrying on his business. We so held in *Commissioner of Internal Revenue* v. *Doyle*, 231 F.2d 635, affirming the tax court's memorandum decision, P-H T.C. Memo 54,340; and *Sullivan* v. *Commissioner*, No. 11841; *Ross* v. *Commissioner*, No. 11842, decided February 13, 1957, F. 2d . It is therefore necessary for us to, and we do, reverse the decision of the tax court to that extent.

2. A part of the judgment of the tax court rests upon its finding of fact that taxpayer overstated his deduction for wagering losses on his return in the amount of $5,000. As to how this figure was arrived at, the record does not fully disclose.

While respondent determined that $48,010.41 of the losses claimed by taxpayer must be disallowed because his reported gross profit amounted to but 5½% whereas the pari-mutuel machines in the state of Illinois operated on a gross profit of 11½ or 12½ per cent, depending upon their location, the tax court discarded this ground for disallowance as being not justified.

The tax court found that the parties have stipulated that petitioner's records for one day[2] during the year 1946 are [fol. 76] to be considered typical of his records for that entire year. There is no written stipulation to this effect in the record. We have examined large parts of the colloquy of counsel upon the trial before the tax court and we are unable to find a clear stipulation to that effect. Upon what, if anything, the counsel agreed, is vague and elusive. The briefs in this court do not clarify the subject.

[2] March 16, 1946.

In the notice of deficiency furnished by respondent to the taxpayer, it is stated that the excess of "gaming receipts over gaming disbursements, or gross receipts reported by you in your income tax return for the taxable year 1946 in the amount of $43,217.65 has been increased by [*sic*] $48,010.41 *on the basis of information on file in the Bureau* * * *." (Italics supplied.) The record does not show what this information was. It is axiomatic that a judgment of the court cannot rest upon facts not presented to it.

It follows that, as to the disallowance of $5,000 of taxpayer's betting losses, the decision of the tax court must be, and it is hereby, reversed and the cause remanded to that court for further proceedings in reference to that subject only.

REVERSED IN PART AND REMANDED IN PART, FOR FURTHER PROCEEDINGS.

[fol. 77] UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 11775

SAM MESI, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Petition for Review of a Decision of the Tax Court of the United States

JUDGMENT—April 5, 1957

This cause came on to be heard on the transcript of the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the decision of the Tax Court of the United States entered in this cause on February 8, 1956 be, and the same is hereby, REVERSED in part REMANDED in part to the said Tax Court of the United States for further pro-

ceedings in accordance with the opinion of this Court filed this day.

[fol. 78] Clerk's Certificate to foregoing Transcript (omitted in Printing).

[fol. 79] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1956

No. 983

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

NEIL SULLIVAN, GRACE SULLIVAN, JAMES ROSS et al.

ORDER ALLOWING CERTIORARI—Filed June 17, 1957

The petition herein for a writ of certiorari to the United States Court of Appeals for the Seventh Circuit is granted. The case is transferred to the summary calendar and assigned for argument immediately following Nos. 862 and 932.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.